LIVING WITH FREE TRADE

Canada, the Free Trade Agreement and the GATT

[illegible]n, Michael M. Hart, Debra P. Steger

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Living with Free Trade
Canada, the Free Trade Agreement and the GATT

The Institute for Research on Public Policy
Centre for Trade Policy and Law

Living with Free Trade
Canada, the Free Trade Agreement and the GATT

Edited by

Richard G. Dearden, Michael M. Hart and Debra P. Steger

Proceedings of a Conference held at the University of Ottawa,
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Foreword

The Canada-US Free Trade Agreement came into effect January 1, 1989, following a period of intense, and often emotional, public debate in Canada. The debate covered both the broad policy implications for Canada of developing closer formal relations with our southern neighbour, as well as the specific obligations contained in the Free Trade Agreement and their relationship to those under the General Agreement on Tariffs and Trade (GATT). One of the effects of this process of debate has been greater public awareness of the overall institutional and legal framework for international trade and its importance to Canada as a trading nation.

The articles in this volume examine the process of implementing the Canada-US Free Trade Agreement, the bilateral agenda for future negotiations under the Agreement, and the interaction between the Uruguay Round of GATT Negotiations and the evolution of the Agreement. Canada is an active participant in the Uruguay Round of GATT negotiations, the most ambitious and extensive Round since the negotiations that established the General Agreement in 1947. Negotiating groups are working assiduously at reducing barriers to trade and clarifying and improving rules. Ground-breaking discussions are taking place in the groups responsible for the "new" issues, including trade in services, intellectual property and investment.

Thus, the papers address some of the issues that will arise as Canadian business moves to take advantage of reduced barriers under the Free Trade Agreement and responds to the challenges of freer trade globally. Together these articles provide a comprehensive overview of the critical trade policy issues affecting Canada as we forge into the last decade of the century.

For the past five years, the Faculty of Law at the University of Ottawa has sponsored a conference for practitioners and policy makers on Canada and the International Trading System. The 1989, fourth, conference marked the inauguration of a new Centre for Trade Policy and Law jointly sponsored by the Faculty of Law and the Norman Paterson School of International Affairs at Carleton University. Both events reflect the growing recognition that Canada's dependence on international trade requires some major adjustments in both policy and practice.

Over the past decade, the Institute has been in the forefront in Canada, in publishing conference volumes and monographs analyzing issues in international economic relations. This is the second year that it has published the proceedings of the Ottawa Law conference. This year's volume is published jointly with the new Centre for Trade Policy and Law.

The papers in this volume illustrate some of the challenges that lie ahead. They indicate how during the 1980s, Canada sought to improve its access to foreign markets through bilateral and multilateral channels, how it used international trade policy to encourge the domestic economy to adjust to more competitive global trading conditions, and the kind of challenges Canada will face in the 1990s. They explain how Canada will pursue its interests not only through the traditional vehicle of multilateral trade negotiations under GATT but also through the Free Trade Agreement with the United States. Together, these papers provide a thorough analysis, by a distinguished group of legal experts and trade policy specialists, of the legal and policy implications of the challenges ahead.

Rod Dobell
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on Public Policy

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and Law

January, 1990

Avant-propos

L'accord de libre-échange conclu entre le Canada et les États-Unis est entré en vigueur le 1er janvier 1989 après une vive polémique, qui a souvent échauffé les esprits au Canada. Le débat a aussi bien porté sur les répercussions générales, en matière de politiques, de liens officiels plus étroits avec les États-Unis que sur les obligations particulières à l'Accord et tout ce qui rattache celui-ci à l'Accord général sur les tarifs douaniers et le commerce (GATT). La controverse a eu notamment pour conséquence de mieux faire connaître à la population le cadre institutionnel et juridique général du commerce international et son importance pour le Canada, nation commerciale.

Les articles qu'on trouvera dans le présent volume portent sur la mise en oeuvre de l'Accord de libre-échange, sur le calendrier des futures négociations bilatérales dans le cadre de l'Accord et sur la façcon dont l'Uruguay Round du GATT interviendra dans l'évolution de l'Accord. Le Canada participe activement à l'Uruguay Round, la ronde de négociations la plus ambitieuse et la plus importante depuis celles qui ont abouti à la création du GATT en 1947. Les négociateurs travaillent d'arrache-pied en vue d'abattre les obstacles au commerce et de clarifier ainsi que d'améliorer les règles existantes. Les groupes qui se penchent sur les "nouveaux" problèmes, notamment les échanges de services, la propriété intellectuelle et les investissements, ne cessent d'établir des précédents.

Les documents qui suivent examinent diverses questions auxquelles pourrait se heurter le monde des affaires canadien quand il essayera d'exploiter les obstacles atténués par l'Accord de libre-échange et de répondre aux enjeux d'un commerce plus libre à l'échelon international. Ensemble, ils donnent un aperçu général des grandes questions de politique commerciale qui toucheront le Canada en cette dernière décennie du 20^e siècle.

Depuis cinq ans, la faculté de droit de l'Université d'Ottawa parraine un colloque sur le Canada et le système commercial international à l'intention des praticiens et de ceux qui forgent les politiques. Le quatrième, en 1989, a été marqué par l'inauguration d'un nouveau Centre de droit et de politique commerciale, conjointement mis sur pied par la faculté de droit et la Norman Paterson School of International Affairs de l'Université Carleton. Ces deux événements montrent que de plus en plus on est conscient qu'il faut apporter d'importants ajustements aux politiques et aux pratiques, étant donné la dépendance du Canada sur le commerce international.

Durant la dernière décennie, l'Institut est resté au premier plan de ces activités au Canada en publiant les actes des colloques et différents ouvrages qui analysent les problèmes propres aux relations économiques internationales. Pour la deuxième année consécutive, il publie les actes du colloque d'Ottawa, cette fois conjointement avec le nouveau Centre de droit et de politique commerciale.

Les documents qu'on trouvera plus loin décrivent quelques-uns des enjeux qui attendent le Canada. Ils montrent comment, au cours des années 1980, le Canada a cherché améliorer son accès aux marchés étrangers par le biais d'accords bilatéraux et multilatéraux, comment il a recouru à la politique commerciale internationale pour amener son économie à s'adapter à une plus vive concurrence sur le marché mondial et quels défis il devra relever au cours des années 1990. On y explique de quelle maniére le Canada défendra ses intérêts, non seulement par le véhicule traditionnel des négociations commerciales multilatérales du GATT, mais aussi par l'entremise de l'Accord de libre-échange avec les États-Unis. Ensemble, ces documents constituent une analyse méticuleuse des conséquences juridiques et politiques des enjeux que nous réserve l'avenir, par un groupe d'éminents spécialistes du droit et du commerce.

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Janvier 1990

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John Coleman was appointed Chairman of the Canadian International Trade Tribunal in September 1988. Before taking on his present duties, Mr. Coleman was a member of the Canadian public service where, in the course of over twenty years, he gained broad experience in international economic, trade and industrial matters in positions in the Department of Finance, at the OECD in Paris and the IMF in Washington, D.C. His last appointment was as Assistant Deputy Minister, International Trade and Finance Branch in the Department of Finance. For the past two years, he has also been the Chairman of the OECD Arrangement on Exports Credits. Mr. Coleman was educated at the University of Toronto and at Carleton University, Ottawa.

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Germain Denis is Assistant Deputy Minister in charge of the Office of Multilateral Trade Negotiations in the Department of External Affairs and International Trade. He was Assistant Chief Negotiator in the Trade Negotiations Office for the Canada-US Free Trade Agreement. Prior to this, he was charged with the automotive trade negotiations with Japan. Mr. Denis was a member of the Canadian delegation to the Tokyo Round of GATT negotiations and was a member of a panel on the agricultural trade dispute between the United States and the European Community. Between 1979 and 1982, he worked in the Secretariat for the Cabinet Committee on Economic Development and in the Department of Regional Industrial Expansion

Rodney de C. Grey

After service with the RCAF in Canada, the United Kingdom and East Africa, Rodney Grey studied at Queen's University, Kingston, Ontario (BA Political Science and Economics, 1947), University of Toronto (MA Political Economy 1948) and the University of London, England (Ph.D 1953). In 1953, he became Executive Assistant to the Minister of Finance (the Honourable Douglas Abbott) and later joined the Department of Finance, dealing with tariffs and trade policy. In 1955, Mr. Grey was appointed Canadian Representative to the GATT Tariff Negotiations Working Party. He was a member of the Canadian Delegation to the "Dillon Round" in 1960-1962 and became Head of the Negotiating Team in Geneva. In 1963, he chaired the GATT Committee that planned the "Kennedy Round" and during that negotiation represented Canada in the group which worked out the Antidumping Code. In 1965, Mr. Grey was appointed Director, International Economic Relations, Department of Finance and, in 1967, Assistant Deputy Minister in charge of the Tariffs, Trade and Aid Branch. In 1975, he was appointed Head of the Canadian Delegation to the "Tokyo Round" with the rank of Ambassador. Mr. Grey is Chairman, Grey, Clark, Shih and Associates Limited, and the author of numerous articles and publications on federal/provincial financial relations and trade policy.

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Michael Hart is Director of the Centre for Trade Policy and Law. An officer in Canada's Department of External Affairs, he was a member of the Canadian team that first prepared and then negotiated the Canada-US Agreement and is currently on leave from the government as a visiting professor in the Norman Paterson School of International Affairs at Carleton University in Ottawa and as a senior research fellow at the Institute for Research on Public Policy. Mr. Hart has published extensively on trade policy matters, including *Canadian Economic Development and the International Trading System* for the 1985 Macdonald Royal Commission.

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Acknowledgements

The papers in this volume were presented at a Conference on "Living with Free Trade: Canada, the Free Trade Agreement and the GATT" held at the University of Ottawa Faculty of Law on May 5, 1989. This was the fourth in a series of annual trade law conferences organized by the University of Ottawa Faculty of Law on the theme "Canada and International Trade," and the first to be sponsored by the newly established Centre for Trade Policy and Law in Ottawa.

The Conference was organized by the Common Law Section of the University of Ottawa Faculty of Law, in cooperation with the Centre for Trade Policy and Law, the Norman Paterson School of International Affairs at Carleton University and the Institute for Research on Public Policy.

The editors wish to acknowledge the splendid effort of Chantal Foré and her team of assistants for organizing yet another first-class conference and to Dean Donald McRae of the Common Law Section for his unflagging support and encouragement. Roxanne Cooligan spent many hours over the course of the summer chasing down and editing the articles that appear in this volume. The final manuscript was prepared for publication by Roxanne Cooligan and Doris Whitteker.

Richard Dearden
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I.

Introduction

Introduction

Richard Dearden, Michael Hart and Debra Steger

The Canada-US Free Trade Agreement came into effect on January 1, 1989, following a period of intense, and often emotional, public debate in Canada. The debate covered both the broad policy implications for Canada of developing closer formal relations with our southern neighbour, as well as the specific obligations contained in the Agreement. One of the incidental benefits of this process has undoubtedly been an increased public awareness of the institutional and legal framework for international trade and its importance to Canada as a trading nation.

The Free Trade Agreement was not created in a vacuum. It was established under Article XXIV of the General Agreement on Tariffs and Trade (GATT) which allows countries to form free-trade areas or customs unions where the result is to achieve greater trade liberalization than would otherwise be possible.

The GATT remains central to Canadian trade policy. It is the basic framework within which Canada's trade relations with the rest of the world are conducted. The Free Trade Agreement borrows heavily from and, in places, expands upon the principles, procedures and institutions of the GATT. How these two major trade agreements evolve and relate to each other will be of critical importance to Canadian businesses and consumers in the years to come.

Canada is currently an active participant in the eighth round of multilateral trade negotiations taking place within the GATT, the Uruguay Round.

This round, scheduled to conclude in late 1990, is the most ambitious and extensive round since the negotiations that established the General Agreement in 1947. Negotiating groups are working assiduously at reducing barriers to trade and clarifying and improving rules in the traditional areas relating to trade in goods. Other groups are making a concerted effort to bring agricultural trade and textiles trade within effective GATT disciplines. Groundbreaking discussions are taking place in the groups responsible for the "new" issues, including trade in services, intellectual property and investment.

The articles in this volume were presented at a conference held in Ottawa on May 5, 1989 "Living with Free Trade: Canada, the Free Trade Agreement and the GATT." The theme of the conference could not have been more appropriate, as Canadian businesses were gearing up to take advantage of reduced barriers under the Free Trade Agreement and to respond to the challenges of freer trade globally. The implementation of the Free Trade Agreement signifies a new era of international business relations for Canada. The issues today are how the FTA will influence business decisions in both countries and how those decisions will affect the competitiveness of the Canadian economy in the years ahead. The intricate ongoing relationship between the FTA and the GATT will also be of crucial importance to Canada's future import and export interests.

The conference also marked the inauguration of the Centre for Trade Policy and Law (CTPL), jointly sponsored by the Faculty of Law at the University of Ottawa and the Norman Paterson School of International Affairs at Carleton University in Ottawa. The promotion of education, research and expertise in the issues of trade policy here at home will be essential to Canada's long-term success as a trading nation. The CTPL has an ambitious agenda to promote greater public awareness and understanding of trade policy issues, to foster independent analysis and research of Canadian trade policy and law, as well as to encourage the professional development of trade policy practitioners.

This volume is divided into two parts. The first part focuses on issues involved in the implementation of the Free Trade Agreement while the second part explores some of the key issues being negotiated in the Uruguay Round.

The dispute settlement mechanisms established under the Free Trade Agreement are of fundamental importance to its successful operation. Chapter 19 of the FTA establishes a system for binational panel review in antidumping and countervailing duty disputes. Chapter 18 of the FTA sets out a separate regime for government-to-government dispute settlement on other aspects of the Agreement, except for financial services.

Washington trade lawyer, and former trade negotiator, Jean Anderson, summarizes the main features of Chapter 19 panel reviews. She raises a number of critical issues that could be the subject of future developments in the FTA including the relative merits and disadvantages of ad hoc panel review versus a permanent bilateral tribunal, including the practical difficulties of a system that requires private sector panellists from one country to become sufficiently familiar with the trade laws and legal system of the other. She concludes that while there remain challenges, the two governments have a major stake in making Chapter 19 work and thus contribute to more harmonious Canada-US trade relations.

The binational panel procedures for antidumping and countervailing duty disputes have received considerable attention in Canada. This may be explained in part by a Canadian perception that United States' administration of its antidumping and countervailing duty laws has been influenced in the past by political concerns. Vancouver trade lawyer Christopher Thomas suggests, however, that the general dispute settlement mechanisms created by Chapter 18 of the FTA may be of even greater significance to the Canada-United States trading relationship in the longer term. He examines the procedures established under Chapter 18 and compares it to the GATT system. He uses a hypothetical "investment" dispute to examine the practical application of the Chapter 18 procedures and its suitability for resolving disputes relating to issues other than trade in goods. In this respect, it has yet to be seen whether Chapter 18 will satisfy these unique needs or whether the careful pragmatism that has characterized the GATT dispute settlement system will carry over into the experience under the FTA. In any event, Thomas notes, the evolution of the FTA dispute settlement system will be a "fascinating process" for academics and trade experts alike.

In a dissenting comment, Washington trade lawyer Stewart Baker questions some of the conclusions developed by Thomas but agrees that the long-term success of the FTA will require bold and imaginative thinking, particularly in the area of dispute settlement.

In order to benefit from duty-free or reduced tariff treatment under the FTA, goods exported from one country to the other must satisfy the rules of origin set out in Chapter 3 of the Agreement. Washington trade lawyer David Palmeter draws attention to the inherent complexity of these new rules. He questions whether these rules will result in greater predictability and transparency (as intended by the drafters of the FTA) or in more bureaucratic arbitrariness, political influence and ultimately, protectionism. The detail and complexity of the new rules may well result in a more predictable and transparent system of tariff classification. Detail and complexity, however, he notes, can also lead to major differences of interpretation and may obscure essential guiding principles. He suggests that perhaps the greatest beneficiary of the new system, at least in the short run, might be the legal profession as lawyers seek to have the rules interpreted in their clients' interests.

The new Canadian International Trade Tribunal came into existence on December 31, 1988 – one day before the FTA came into effect. The CITT is an amalgamation of the three federal agencies formerly responsible for international trade – the Canadian Import Tribunal, the Tariff Board and the Textile and Clothing Board. John Coleman, first Chairman of the CITT, explains the rationale and benefits of consolidating the trade remedy and general economic inquiry powers of the CITT's predecessors in one tribunal. He also outlines the expanded powers of the CITT, and points out that the Tribunal has an important role to play in future in helping to make the Agreement work.

Although much of the Free Trade Agreement has already been implemented, there remain important areas of unfinished business. Michael Hart, Director of the CTPL, addresses the continuing negotiating agenda. He maintains that, while Canada and the United States may not succeed in reaching consensus on subsidies and countervailing duties, viewed by many as the most prominent and difficult issue on the continuing agenda, the work of the FTA trade rules Working Group, as well as the GATT negotiations, will nevertheless have positive ramifications for the bilateral trading relationship. Hart's thesis is that international trade agreements thrive on a continuing program of negotiation and change. "Living With Free Trade" at this point in the history of the FTA means improving and expanding the interim regime for subsidies and countervailing duties, and building on the sound basis created in the FTA for resolving other areas of contention, such as rules covering dumping and government procurement preferences. In this sense, the FTA marks an important milestone in the transition from a largely power-based, diplomatic relationship between Canada and the United States to one based on rules and formal dispute settlement.

The second series of papers in this volume concentrate on developments in the Uruguay Round of multilateral trade negotiations. They emphasize the significant links between the FTA and the MTN. While Canadian trade policy is being pursued along two tracks, the same goals are being sought in each. Canada's Assistant Deputy Minister for Multilateral Trade Negotiations, Germain Denis, analyzes the "intimate and complex relationship" between the FTA and the GATT, arguing against the misconception that the two agreements are alternative, mutually exclusive trade policies for Canada. Indeed, progress in the multilateral trade regime may well depend on progress in the bilateral regime and vice versa. He points out the several areas in the FTA, such as agriculture, intellectual property and government procurement, where the negotiators directed the two countries to make significant efforts to achieve multilateral agreements on these issues in the Uruguay Round.

Judith Bello and Alan Holmer, Murray Smith and William Davey address current issues in the Uruguay Round. Bello and Holmer discuss the purpose and possible outcome of the negotiations on international protection of trade-related intellectual property rights; Smith examines the prospects for a multilateral agreement on trade in services; and Davey assesses the significance of the provisional GATT dispute settlement reforms already adopted at the Montreal mid-term review meeting in December, 1988 and makes some proposals for how the outstanding issues of adoption, implementation and compensation/retaliation could be resolved.

Bello and Holmer outline the importance attached by the United States to early progress in establishing a multilateral system of rules and dispute settlement procedures to protect intellectual property. Failure to achieve this goal would, in their view, result in the United States having to resort to unilateral and bilateral means to achieve the same goals, and would undermine the effective functioning of the multilateral trading system. Thus, a multilateral agreement on intellectual property rights could prove beneficial for all trading nations, while failure to achieve it could result in discord.

Murray Smith reviews the importance of achieving a multilateral agreement on services trade. He concludes that the Canadian economy would be among the beneficiaries of a global agreement that creates more transparency and predictability for service transactions. He cautions, however, that the issues are sensitive and complex. Progress might best be achieved, he argues, by a less ambitious approach, based on national treatment but which exempts sensitive sectors (such as the cultural industries) and provides a multilateral dispute settlement mechanism.

William Davey analyzes the changes adopted at the Montreal mid-term ministerial meeting to streamline the GATT dispute settlement process and concludes that these changes are more cosmetic than real. In order to equip the system to deal with the challenges it now faces as a result of a dramatic increase in the number and complexity of cases, it will have to become more professional and less dependent on the intimate involvement of contracting parties, particularly those with an interest in the issue being litigated. He also emphasizes the importance of automatic adoption and expedient implementation of panel decisions if the GATT system is to continue to function effectively.

Former Canadian Ambassador to the Tokyo Round Negotiations, Rodney de C. Grey, closed the conference with his views on the future of the multilateral trading system generally and on the central role that the GATT continues to play in that system. His analysis is essentially pessimistic. He points to the extent to which observance of the original principles upon which the GATT was founded has eroded, while the rhetoric assumes their continued application. He notes that the Uruguay Round is a short-term project with long-term implications and that "... it will leave in its wake an unfinished agenda." It is that long-term agenda, including effective rules to discipline trade in agriculture, more effective dispute settlement procedures, a more realistic approach to trade between states with market-based economies and centrally-planned economies, reform of the contingency protection systems and more effective functioning of the GATT as an institution, that will determine the ultimate success or failure of the multilateral trade relations system. What is achieved in the Uruguay Round, as well as the decisions made by governments in implementing its results, he believes, will have a significant bearing on the long-term viability of a GATT-centred trade relations system.

Together these articles provide a comprehensive overview of the critical trade policy issues affecting Canada as we forge ahead into the last decade of the twentieth century.

II.

Resolving Trade Disputes

Resolving Trade Disputes through Binational Panels and Extraordinary Challenges: Issues in Implementing Chapter 19 of the Canada-United States Free Trade Agreement

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Jean Anderson

The unique provisions in Chapter 19 of the Canada-United States Free Trade Agreement (FTA) for binational panel dispute settlement in antidumping and countervailing duty cases have attracted a great deal of attention for over a year and a half. Since the Elements of Agreement were announced on October 4, 1987, negotiators have explained them, politicians have debated them and scholars and trade law practitioners have carefully analyzed them. The binational panel provisions have met with unqualified praise, substantial skepticism and occasional outrage – a full spectrum of opinion on whether they are wise and whether they are workable.

We are now on the verge of finding out which predictions are right. The Free Trade Agreement – and with it, each country's implementing legislation and regulations, the jointly agreed Rules of Procedure for Article 1904 Binational Panel Review and the Code of Conduct for dispute settlement proceedings – has now been in force for over four months, and the first tests of the binational panel machinery are under way. Indeed, as of the beginning of May 1989, requests had already been filed seeking binational panel review of five separate final determinations.

Will Chapter 19 work and, if so, how well? Will the panel process be administrable? Will it require some tinkering to make it work better? Or will the two governments have to go back to the drawing boards?

As you might guess from my history as the chief US negotiator for subsidies, antidumping and binational panel dispute settlement in the FTA, I have confidence in the binational panel process. In fact, I think some of the concerns that have been expressed will prove to be unimportant, and some of the suggestions for "improving" it would fundamentally weaken the process and its credibility. But I do not assume that we have created a flawless system. So I am happy to have the opportunity to address a few of the issues that I think are worth watching as the first tests of the process proceed.

The Binational Panel Process

A brief description of Chapter 19 will help put these issues in focus. Chapter 19 has three main elements. First, Article 1903 creates safeguards against either country undercutting the intent of Chapter 19 or the FTA as a whole through amendments to its antidumping (AD) or countervailing duty (CVD) law. An amendment to either country's AD or CVD law applies to the FTA partner only if the amendment so specifies and in such case, the amendment is subject to advisory panel review for consistency with the FTA and the GATT and, if necessary, remedial legislation or other action.

A second important element is the establishment in Article 1907 of a binational Working Group charged with trying to achieve what we failed to achieve within the political time constraints of the FTA negotiations: agreement on "more effective rules and disciplines concerning the use of government subsidies" and "a substitute system of rules for dealing with unfair pricing and government subsidization."

The third element is, of course, Article 1904's system of binational panel review of final determinations in AD or CVD cases (for example, dumping or subsidy determinations by the US Department of Commerce or Canada's Deputy Minister for Customs and Excise at Revenue Canada, and material injury determinations by the US International Trade Commission or the Canadian International Trade Tribunal).

Under this system, an ad hoc, five-member binational panel will be appointed to review a final determination at the request of anyone who would have had the right to obtain court review of the determination. Substituting for the national court, the panel will decide whether the administrative agency or tribunal applied its national law correctly. Panel review will be based on the administrative record and will apply the same standard of review and general legal principles as would have been applied by the domestic court in the importing country. A panel decision is binding on the two governments with respect to the particular matter which the panel reviewed, but is not a binding precedent for domestic courts or binational panels reviewing subsequent AD/CVD determinations.

The implementing statutes of both countries preclude judicial review of a final AD or CVD determination once panel review has been requested, and preclude appeals of panel decisions to national courts. Provisions for court review of constitutional challenges to the panel system (or review of constitutional issues arising out of an AD/CVD determination) in addition to the FTA's extraordinary challenge procedure protect both the exclusive jurisdiction of panels to review AD or CVD determinations as well as the integrity of the panel process as a whole.

The challenge procedure is not an appeal as of right, but an extraordinary safeguard against a panel run amok. If either government believes, for example, that the integrity of the panel process is threatened because a panel member had a serious conflict of interest or because the panel has exceeded its authority under the Agreement, either government may invoke review by a three-person binational Extraordinary Challenge Committee (ECC), composed of judges and former judges. ECC decisions – to affirm, vacate (for a new panel review) or remand the panel decision – are, like panel decisions, binding with respect to the particular matter addressed.

Issues to Watch

The Ad Hoc Panel Appointment Process

Some suggest that a permanent Canada-US tribunal would be preferable to the ad hoc panel system under the FTA. Among the justifications for this suggestion are that a permanent tribunal would develop its own unique, binational (and precedential) law on subsidies and dumping that might be valuable to the FTA Working Group; that a permanent tribunal would render more consistent decisions reflecting a constantly increasing institutional expertise; and that the ad hoc panel process is likely to be an administrative nightmare.

The pros and cons of permanent and ad hoc panels are too complex to cover fully and fairly here. To put it simply, I think the idea of a permanent tribunal is, at best, ahead of its time. It fits a free trade agreement that has not yet been negotiated. The free trade agreement that the prime minister of Canada and the president of the United States signed – and that emerged (after considerable doubt) unscathed from the battles of Canadian public opinion and both countries' legislatures – is a free trade agreement that leaves development of disciplines and rules on subsidies and dumping to a careful negotiation, and that requires a public consensus through a political process in both countries before the disciplines and rules take effect. Until then, because both countries retain the right to apply their AD and CVD laws (with binational review to ensure their correct, nonpolitical application), the laws are generally a known quantity within which industries can trade.

If there were a permanent tribunal – bound, if at all, to apply its own precedent rather than to apply either separate though similar national laws (as we have now) or a bilateral system legislated in each country (as we might have in the future) – could not the tribunal, bit by bit, prohibit all regional subsidies? How would the Canadian public react? And would not creation of such a tribunal be an abdication by the governments of the responsibility to negotiate agreements that are publicly acceptable or have the agreements fail?

Nor do I think a permanent tribunal is needed for consistency and expertise. Consistency is probably less important than it sounds and more likely to occur in the ad hoc panel process than one might at first think. Virtually identical issues are likely to emerge with frequency in the different AD and CVD cases before panels in the five-to-seven year life of the panel system. Moreover, five-member panels will arguably help avoid extreme decisions that might encourage inconsistency. Finally, the high quality of both countries' initial rosters suggests that panels will have a great deal of trade law knowledge and expertise.

On the other hand, an ad hoc panel process is not easy to administer, and the system may require some tinkering for it to work smoothly. Under the FTA, the governments generally are to appoint panelists from a 50-person roster (25 from each side) of private lawyers and others familiar with international trade law. Almost by definition, they will be engaged in other activities and will sometimes have conflicts of interest that would preclude their participation on a particular panel. When a panel is requested, the two governments must check possible conflicts or unavailability of roster members and follow a detailed appointment procedure, perhaps including peremptory challenges, to have a panel in place in 61 days. As is the case now, a number of panels may be in formation simultaneously.

All of this suggests that some early amendments to the Rules of Procedure may be necessary, and that a roster of 25 members from each side may be insufficient – at least for the United States. While the FTA permits appointment of an individual from outside the roster, and the Canadian government can do so, the US government cannot. Always wary of the Executive Branch, the US Congress established an elaborate procedure and timetable for US appointments of roster members, and barred the US Trade Representative from naming anyone outside that process to a panel. While the system is not totally unworkable, it is cumbersome where flexibility may be essential.

National Expertise in a Binational System

As noted, the initial rosters are impressive for the trade law knowledge and expertise of its members. But one point is plainly of concern, perhaps most to the panelist themselves: will a panel member – even one who is a trade lawyer with vast experience in Canadian (US) trade cases – know enough about the trade laws and legal system of the United States (Canada) to be able to decide a case on review? If not, what is the solution? And how much harder will it be for a nonlawyer, or a lawyer who knows international law, but not the Byzantine complexities of the AD and CVD laws of either country?

These are fair questions, and we can applaud the roster members who are concerned about them for their strong sense of responsibility to the process. But the best answers are, I think, implicit in the FTA itself.

First, it is essential that a panel member understand the panel's mandate in Chapter 19 of the FTA: the panel is to review a final determination, based on the administrative record, to determine whether the determination was in accordance with the AD or CVD law of the importing country, and must apply the standard of review and general legal principles of the importing country.

Second, the Parties will brief the issues, probably more comprehensively than they do in judicial review. The panelist will, of course, have a heavy burden of studying the record, participants' submissions, the relevant statute, and the precedents cited (but will at least have the assistance of a law clerk).

Third and most important, there appears to be no way to provide greater comfort to concerned panelists without jeopardizing their independence or, at the very least, giving a new issue to litigators before the panel. Interestingly, the idea of a permanent general counsel's office for the panel process was raised in the negotiations, and was rejected by both sides. The concern was that, particularly over time, panel decisions would be unduly influenced – if not in effect made – by the general counsel rather than by the panelists. And if, for example, the governments organized a short course or offered materials to panelists on their own law or the law of the other country, a litigant would surely argue that the governments had swayed the decision.

Other Issues

Among the myriad other issues to watch for are these:

- The role of the Secretariat: Should it be purely administrative, as provided in the FTA, or should it be substantive? As the only permanent part of the panel process, will it inevitably take on more substantive responsibility? This raises the same issues of panel independence and potential influence on panels discussed above.

- How panels and national courts will function in cumulation cases: This was carefully worked out in the FTA, which is designed to protect exclusive panel jurisdiction in US-Canada cases, yet prevent third countries from benefiting from the FTA through the cumulation back door. A protective panel request was filed at the beginning of May 1989 in a case involving cumulation. The first trial of the provisions of the FTA could, therefore, come soon.

- Consolidation before a single panel of the review of the material injury determination and the review of the dumping or subsidization determination in the same case: Included in the Rules of Procedure under Joint Panel Reviews (rules 36-37), these provisions arise both from US constitutional "case or controversy" concerns and from the desire to permit participants to opt for a streamlined review process where appropriate. Whether joint panel rules should be broadened to permit or require more joint reviews will probably depend on whether participants before panels favour the procedure and on an assessment of the burden on panel members.

- The extraordinary challenge procedure: Since only a government can invoke the procedure, there may be a theoretical danger that both governments would refuse to do so and a court would intervene. In the United States, court jurisdiction would almost certainly arise only under the provisions for constitutional challenges, which include constraints and sanctions to discourage frivolous claims. What about Canada? Separately, is the integrity of the panel process maintained in the complex ECC procedure for challenges alleging conflicts of interest by a panel member? Are the individual's rights sufficiently protected?

- Constitutionality: Is a challenge to the constitutionality of the process likely? Will the panel process withstand the challenge?

Certainty on some of the more fundamental issues on this list may be years, or forever, in coming. What is certain now is that binational panel dispute settlement is important for the FTA as a whole and that the two governments have a major stake in making it work. With five panel reviews initiated and more on the horizon, they can start to make small but significant improvements in the process that cumulatively could transform a temporary, binational panel system into a permanent feature of the US-Canada bilateral relationship.

General Dispute Resolution Under the Free Trade Agreement: The Chapter 18 Procedures

J. Christopher Thomas

For much of the free trade negotiations and the ensuing federal election campaign, considerable attention was paid to the real and imagined shortcomings in the enforcement of the US antidumping and countervailing duty laws. One measure for evaluating the outcome of the negotiations is the Chapter 19 binational dispute settlement procedures for use in unfair trade cases and the upcoming negotiations on new methods for dealing with subsidies and unfair pricing disputes. No doubt the debate over the outcome of this part of the free trade negotiations will continue for some time.

Lost in the brouhaha surrounding the "contingency protection" laws was the fact that progress was made in other areas of dispute settlement. In fact, the Free Trade Agreement (FTA) contains a number of different mechanisms for resolving disputes. There is the specialized dispute settlement process of Chapter 19 mentioned above. In addition, disputes arising over the provisions of Chapter 11 – the safeguards chapter – are expressly subject to binational binding arbitration. Finally, virtually everything else covered by the FTA is subject to the Chapter 18 dispute settlement procedures.[1] These procedures and other consultative mechanisms were reviewed in an interesting paper presented by Leonard Legault in the 1988 Ottawa Trade Law Conference. Mr.

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[1] Financial services are excluded from dispute settlement. In view of an expressly unfinished negotiation, any disputes concerning financial services are subject to discussions between the Treasury Secretary and the Minister of Finance.

Legault's paper covered the entire range of dispute avoidance and settlement procedures open to the two governments under the Agreement.[2]

As fascinating as Chapter 19's experiment of replacing judicial review with binational panels may be, Chapter 18 may be of greater relevance and importance in terms of the frequency of use and applicability to the day-to-day stresses of the Canada-US trading relationship. If recent experience in the GATT is any guide, these procedures are likely to be invoked quite frequently.

Over the last two years, Canada and the United States have launched two direct challenges to each others' trade policies and have intervened in an number of other cases. Canada has challenged the US customs user fee and the Superfund taxes on imported petroleum substances, while the United States has taken aim at restrictions on exports of unprocessed salmon and herring and, more recently, at Canadian restrictions on the importation of ice cream and yogurt. The 1986 Softwood Lumber countervailing duty case also led to GATT dispute settlement proceedings, but when the Memorandum of Understanding settling the case was concluded, the GATT was informed that a mutually satisfactory solution had been achieved.

Both countries have also taken positions on GATT cases launched by other states. For example, Canada has supported the European Community in its complaint against the United States-Japan semiconductor agreement and the United States has supported the Community's challenge of Canada's discriminatory practices in respect of imported alcoholic beverages.

If these disputes are any indication, Chapter 18 may be invoked quite frequently. Hence its relevance to this Conference. A review of Chapter 18 shows that it is derived in large part from GATT dispute settlement procedures as they have evolved over time. It departs from GATT procedures by stipulating more rigorous time schedules, reducing a party's opportunity to stall and establishing lists of exclusively nongovernmental panelists.[3]

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[2] His paper has been reproduced with the rest of the conference proceedings in Donald M. McRae and Debra P. Steger, eds, *Understanding the Free Trade Agreement* (Halifax: Institute for Research on Public Policy, 1988).

[3] An interesting comparison of GATT dispute settlement and the various FTA procedures was made by Robert E. Hudec at last year's Ottawa Conference. See "The FTA Provisions on Dispute Settlement: The Lessons of the GATT Experience," in Donald M. McRae and Debra P. Steger, eds, *Understanding the Free Trade Agreement* (Halifax: Institute for Research on Public Policy, 1988).

After briefly reviewing the Chapter 18 procedures, this paper will examined a hypothetical case study. My objective is to raise some issues pertaining to the effectiveness of the FTA dispute settlement process, specifically with respect to remedies.

What Can be Taken to Dispute Settlement?

Consistent with the approach taken in the GATT, there are two main avenues open to a Party. First, where a violation of a specific provision of the FTA is alleged, dispute settlement proceedings can be commenced. Second, there may be instances where a Party has not violated an express provision but has acted in such a way as to "nullify or impair" a benefit reasonably expected to accrue to the other Party directly or indirectly under the Agreement. This latter avenue (found in Article 2011) is clearly derivative of, albeit not cast in the same terms as, Article XXIII of the GATT.

GATT Article XXIII provides that a contracting party may make representations to another where it considers "that any benefit accruing to it directly or indirectly" under the GATT "is being nullified or impaired or that the attainment of any objective" of the GATT is, *inter alia* , being impeded as a result of a party's failure to carry out its obligations or its application of a measure "whether or not it conflicts with the provisions" of the GATT. FTA Article 2011 similarly provides: "if a Party considers that the application of any measure, whether or not such measure conflicts with the provisions of this Agreement, causes nullification or impairment of any benefit reasonably expected to accrue to that Party, directly or indirectly under the provisions of this Agreement, that Party may [commence proceedings]." Thus, like Article XXIII of the GATT, Article 2011 relieves a Party of the necessity of identifying an actual contravention of the Agreement before invoking dispute settlement procedures. If a benefit reasonably expected to accrue from the FTA is nullified or impaired, dispute resolution proceedings can be launched.

It is important to note that the Free Trade Agreement co-exists with the dispute settlement provisions of the GATT and the Tokyo Round Codes. This is made clear by Article 1801:2 which provides that disputes arising under both the FTA and the GATT and agreements negotiated thereunder "... may be settled in either forum, according to the rules of that forum, at the discretion of the complaining Party." This introduces an element of forum shopping for matters arising under the FTA and GATT. It may be that a Party will view its chances of success as better in one forum than in the other. For example, if there appears to be a broad consensus in the GATT that a respondent state practice is objectionable, it may be tactically advantageous to seek a GATT panel rather than to invoke the bilateral dispute mechanisms.

Getting Matters Before a Panel

The institutional arrangements of the FTA are sparse. The central body created to oversee the operation of the Agreement and to resolve any disputes that may arise thereunder is the Canada-US Trade Commission, comprised of the ministers responsible for trade: the Minister of International Trade and the US Trade Representative. Although the Commission meets at ministerial level, it is contemplated that designated senior officials could meet as well (Article 1802:2).

Prior to sending a matter to a panel proceeding, the Agreement requires that certain preliminary stages be completed. Consistent with established GATT practice, a process of notification and consultation is envisaged. Normally, informal consultations would take place at the outset; the Parties are under an obligation to "make every attempt to arrive at a mutually satisfactory resolution" of the matter. If the matter is not resolved within 30 days of the request for consultation, either Party may request a meeting of the Commission. The request must state the matter complained of and indicate the provisions of the Agreement considered relevant. Unless otherwise agreed, the Commission will meet within 10 days to attempt to resolve the dispute.

If the Commission is unable to resolve the matter within 30 days after the referral of the matter, it may refer a dispute to binding arbitration on such terms as it may adopt. Keeping in mind the terms of Article 1802:5 which establish that all decisions of the Commission "shall be taken by consensus," no dispute can go to binding arbitration unless both Parties concur.

This does not mean that the dispute settlement procedures of the FTA are eviscerated by stalemate. The institutional provisions would be unsatisfactory if consensus is required before any dispute settlement panel could be created. Fortunately, this is not the case. For somewhat anomalous reasons of drafting, buried in Article 1807 "Panels Procedures" (which one might expect amplifies the binding arbitration procedures of Article 1806) is another form of dispute settlement which does not require the consent of both parties to be invoked. Article 1807:2 provides:

> If a dispute has been referred to the Commission under Article 1805 and has not been resolved within a period of 30 days after such referral, or within such other period as the Commission has agreed upon, or has not been referred to arbitration pursuant to Article 1806, the Commission, upon request of either Party, shall establish a panel of experts to consider the matter. A panel shall be deemed to be established from the date of the request of a Party.

Thus, upon request of either Party, the Commission is obliged to establish a "recommendatory panel." Naturally, and in contrast to Article 1806 procedures, such a panel cannot render a binding decision. Under Article 1807:8, however, a presumption is built into the FTA. According to that provision, "upon receipt of the final report of the panel, the Commission shall agree on the resolution of the dispute, which shall normally conform with the recommendation of the panel." The fact that the panel issues a mere recommendation does not mean that the Parties are free to ignore it. GATT panels similarly make findings and recommendations to the GATT Council and the rate of compliance with panel decisions by contracting parties is quite high. Indeed, it could be argued than an international dispute settlement procedure that confers some latitude in the process of compliance may be actually more effective than a more rigid adjudicatory procedure.[4]

This recommendatory panel process, which is very similar to the general GATT dispute settlement process (especially now that the Uruguay Round reforms are being implemented on a provisional basis[5]), is likely to be used more frequently than binding arbitration. The inability of a Party to block the other Party's request for the creation of a panel, the inherent value of objective third-party fact-finding and the flexibility in compliance with the recommendation should all make the procedure a workable and effective one. Furthermore, the existence of a qualified right to retaliate for failure to reach a mutually satisfactory resolution of a dispute in which a recommendatory panel report was issued provides some force of sanction (see Article 1807:9 in this regard).[6]

A Hypothetical Case Study

In order to better understand the general dispute settlement process, it is useful to consider a hypothetical case study. I have intentionally selected a non-trade dispute, specifically a dispute over investment. One of the important achievements of the free trade negotiations was the expansion of the substantive content of a conventional free trade agreement to embrace the so-called new issues of international trade law: services and investment and, perhaps the most interesting, temporary business travel. While the substantive content of the FTA is broader than other regional trade agreements (with the main exception of the more far-reaching European Economic Community), the general dispute settlement procedures have been drawn from GATT experience, an experience which to date has been entirely restricted to trade disputes (although there have been cases such as the FIRA and DISC cases where GATT panels have addressed the trade-related aspects of investment regulation and tax law, respectively). Thus, one question that immediately comes to mind is how suitable are dispute settlement mechanisms developed for trade disputes when these are applied to different matters? The following hypothetical case (which some may recognize resembles a recent case) should help to address this question.

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[4] The features of the GATT process are discussed in Olivier Long, *Law and its Limitations in the GATT Multilateral Trade System* (Dordrecht: Martinus Nijhoff, 1985), pp. 71-88.

[5] These reforms are contained in the Decision of the Trade Negotiations Committee meeting held in Montreal in December, 1988. See MTN.TNC/7 (MTN) 9 December 1988.

[6] The FTA also contains a rather anomalous provision that exists independently of the binding arbitral and recommendatory processes. Article 1808 contains a faint echo of supranationality in contemplating the involvement of the FTA's institutions in domestic administrative or litigation proceedings even though neither country has implemented the FTA is such a way as to permit its courts to pronounce upon matters which would normally fall within the Commission's "jurisdiction."

As part of a restructuring plan to take advantage of the Free Trade Agreement, Canco, a Canadian-based corporation controlled by Canadian nationals, decides to acquire Amco, a major American corporation based in Ohio. The takeover bid is poorly received. Amco's Board of Directors views Canco as a hostile bidder and engages in defensive tactics, one of which is to politicize the bid.

In view of increasing public concern over foreign acquisitions of American businesses, the Governor of Ohio threatens passage of an anti-Foreign Takeover Law which would create an investment screening procedure. The Governor states publicly that, if the law is enacted, he would not permit the proposed Amco acquisition to proceed. Given the pressure of time normally surrounding a takeover, it is essential to Canco that this state government action, which it views as contrary to the FTA, be addressed as soon as possible in order to preserve the bid.

Analysis

Since the dispute involves an investment issue, the provisions of Chapter 16 apply. The relevant provision is Article 1602:4, whereby the Parties have agreed to extend a qualified right of national treatment to investors of the other Party. Specifically, each Party (including states and provinces) is to accord to investors of the other Party treatment no less favourable than that accorded in like circumstances to its own investors with respect to such matters as the acquisition of business enterprises situated in its territory. This national treatment obligation is qualified by Article 1607 which "grandfathers" all existing discriminatory measures.

Since Ohio did not have investment acquisition measures that discriminated against foreigners prior to the entry into force of the FTA, a discriminatory measure such the the anti-Foreign Takeover Law would not be grandfathered. Accordingly, it would be in conflict with the provisions of Article 1602 because Canco would be threatened with less favourable treatment than that accorded to an American investor in like circumstances. Thus, there is a *prima facie* case of contravention of the FTA.

The Dispute Settlement Process

Canada does not have a statutory equivalent to section 301 of the US Trade Act of 1974. Hence the procedures for petitioning the Government of Canada to complain about Ohio's alleged interference in the Amco acquisition are not presently in statutory form. Presumably, Canco would contact the Minister for International Trade, outline its concerns that Ohio's threatened action might thwart the acquisition and request the Minister to employ the dispute settlement machinery of the FTA to obtain a satisfactory resolution of the matter. In the absence of a procedure prescribed by law, it is unlikely that there would be any means to compel the Minister to act.[7]

This raises a potential problem for Canadian parties seeking to challenge US government action under the FTA. Cases originate as private concerns but then feed into the government's policy process. It is virtually certain that policy considerations that are important to a government but secondary or peripheral to the affected private party will arise. If these considerations outweigh the private party's interest, the government may not prosecute the case. Clearly, there is room for conflict between the government's discretion to refuse to raise a matter and a private party's call for action. In the United States, Congress has tipped the procedural balance in favour of private parties at least insofar as investigating an alleged breach of a trade agreement is concerned. To date, Canada has not gone so far.

Assuming the Minister agreed that Ohio's action appeared to constitute a contravention of the Chapter 16 national treatment obligation, the question of what kind of dispute settlement process should be followed would arise. Quite apart from the general dispute settlement procedures of Chapter 18, Chapter 16 contains specific language regarding investment disputes.

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[7] Section 26 of the *Customs Tariff* (R.S.C. 1970, c. C-41 is roughly analogous to section 301 of the US *Trade Act* of 1974. It permits the Governor in Council to take action to get the Minister of Finance and the Secretary of State for External Affairs to recommend to the Governor in Council to act. It would appear, therefore, that there is a need for legislation to provide a procedure for petitioning an investigation.

The language of the relevant provision, Article 1608, reflects the historic disagreement between the two countries with respect to the treatment of foreign investment (although that disagreement is gradually disappearing as the United States has begun to display the same ambivalence to foreign investment that Canada has had in the postwar period). Article 1608 clearly reflects a compromise between the US interest in compulsory arbitration of investment disputes along the lines envisaged in the ICSID Convention, and Canada's aversion to compulsory arbitration of such disputes. The result is the following:

> In view of the special nature of investment disputes and the expertise required to resolve them, where the procedures of Chapter 18 ... are invoked, the Parties and the Commission shall give the fullest consideration, in any particular case, to settling any dispute regarding the interpretation or application of this Chapter by arbitration or panel procedures pursuant to Articles 1806 or 1807, and shall make every attempt to ensure that the panelists are individuals experienced and competent in the field of international investment. When deciding a dispute pursuant to Articles 1806 or 1807, the panel shall take into consideration how such disputes before it are normally dealt with by internationally recognized rules for commercial arbitration (Article 1608:4).

Assuming the Minister for International Trade agreed with Canco's characterization of the problem, the first step of the process would be to seek informal consultations with the United States. Given that the facts of the case point to a rather clear-cut potential contravention of Chapter 16, it may be that the US government would agree with Canada's objection and undertake to convey to the Governor of Ohio the shared assessment that the proposed law would have to exempt Canadian investors from its application and that Canco's proposed acquisition should be allowed to proceed on its own merits according to established federal and state laws.

This raises an interesting procedural question. Article 2011 speaks of measures which may or may not conflict with the FTA. "Measure," as defined in Article 201, "includes any law, regulation, procedure, requirement, or practice." The definition is not exhaustive. But is the threat of FTA-inconsistent legislation sufficient to support panel proceedings? Or must the threat actually be carried out before a Party can launch proceedings?

This procedural issue aside, assuming the United States agreed that Ohio's action would violate the FTA if it did not exclude Canadian investors, what would happen next? Neither country has chosen to make the FTA a self-executing treaty (indeed, the FTA was implemented in the United States by way of federal legislation rather than Senate treaty ratification). FTA Article 103 makes it clear that both governments are obliged to "ensure that all necessary measures are taken to give effect to ... [the Agreement's] provisions, including their observance ... by state, provincial and local governments." It is not clear to a Canadian observer what avenues are open to the US government to use more than moral suasion were the Governor to ignore the two federal governments' objection.

With the rapidly increasing number of foreign acquisitions of American firms, there has been much discussion about whether Congress should preempt state legislation in this area. A case such as the Canco acquisition could frame the issue in clear terms: if the Executive concludes that a state has enacted legislation that is inconsistent with an international investment obligation, should it seek preemptive congressional action?

The situation in Canada is, of course, murkier; it is not clear that the federal government has the jurisdiction necessary to force a recalcitrant province to act consistently with Canada's international obligations. Notwithstanding the rhetoric of the election campaign, the federal government was careful to avoid asserting an expansive federal jurisdiction under the treaty-making, trade and commerce or the "Peace, Order and Good Government" powers. Instead, the government reserved the narrow power to compel the provinces to comply with the pricing and distribution obligations of Chapter 8.

These constitutional and political considerations aside, if history is any guide, it may be unduly optimistic to assume that the United States would share – at least publicly – Canada's view that Ohio's threatened action was inconsistent with the FTA. States are not known for the rapidity with which they reach a decision, let alone an acknowledgment that their policies are contrary to an international obligation. If Canadian and American practice in the GATT is a reasonable indication, given the need for intragovernmental discussion, deliberation and consultation with affected domestic interests as well as the general reluctance to move too quickly in order to to avoid criticism of appeasing foreign interests, it may be that both governments will move cautiously – at least in the informal consultation period – when addressing an allegedly inconsistent action.

If this is the case, then a formal request for a meeting of the Canada-United States Trade Commission would likely be made. Unless otherwise agreed, the Commission would meet within 10 days of the request. Assuming it met within 10 days, the Commission would then have 30 days to resolve the matter through discussions. If the matter is not so resolved, then either of the two dispute settlement procedures, binding arbitration or recommendatory panels, would be invoked. As noted earlier, Article 1608 contains language which suggests how an investment dispute ought to be handled. The language is not mandatory.

From Canco's perspective, if the threat of state action was not removed by this point, practically speaking the commencement of arbitration or panel procedures, regardless of their outcome, might do little to protect its takeover bid. Since time is usually of the essence in such matters, the bid may be thwarted by the mere threat of state action. This points to one of the potential problems of the general dispute settlement process. It is, of course, a means for resolving disputes between states rather than private parties, even though the disputes may be generated by private parties. Thus, the pace of dispute resolution envisaged by the FTA, though expeditious by comparison with GATT panels of a decade ago, is still slow compared to domestic litigation. The means of preserving a Party's position by way of interim injunctive relief which is often critical to "time-sensitive" litigation are absent from the FTA. Thus, for matters such as takeover bids where time is of the essence, the dispute settlement process of the FTA may be unable to respond.

Of course, the outcome of a panel or arbitral process could be constructive even if the specific takeover bid in question failed because of the FTA-inconsistent action. First, a panel or arbitral decision could help to depoliticize the issue – as an issue between the two Parties to the Free Trade Agreement – because an impartial panel of experts would determine the consistency of the impugned state action with the FTA. This kind of independent third-party fact-finding contributes to the maintenance of the relationship. Second, a determination whether the impugned state action was inconsistent with the FTA would clarify the Agreement's meaning, providing guidance for future disputes involving similar facts. Finally, the arbitral or recommendatory panel could fashion an adequate remedy (or at least recommend one) assuming it found that the state action was inconsistent with the Agreement. Such a remedy could go beyond the specifics of the Canco case to recommend federal action to preempt or in some other way discipline FTA-inconsistent state action. Alternatively, it might simply be restricted to resolving the Canco case by recommending that if the bid had been effectively thwarted by the Governor's action, damages should be award to Canco. Finally, a panel could conceivably combine a case-specific remedy with a broader recommendation to the governments.

The broader recommendation, of course, is what normally results from GATT proceedings. Where a panel finds that a contracting party's action has been inconsistent with the General Agreement, it normally recommends that the offending country bring its practices as soon as possible into conformity with its obligations.

Indeed, insofar as recommendatory panels are concerned, the FTA expresses a preference that the offending measure be removed. Article 1807:8

states: "whenever possible, the resolution shall be non-implementation or removal of a measure not conforming with this Agreement or causing nullification or impairment in the sense of Article 2011 or, failing such a resolution, compensation."

To fashion a narrower remedy such as an award of damages, however, would represent a major departure from GATT dispute settlement practice. One of the central characteristics of GATT practice has been that remedies have been prospective rather than compensatory. A continued flow of trade is assumed; the implementation of a ruling against a trade-restricting practice generally leads to the removal of the restriction and a consequent "freeing-up" of trade. The remedy does not lead to actual financial compensation for lost commercial opportunities.

This is not to say that a panel could not fashion a recommendation that a contracting party pay compensation to another. These appears to be nothing in the General Agreement itself that would preclude such a recommendation (although presumably a panel's terms of reference would have to specify that the panel could deal with the question of such a remedy). Moreover, international proceedings outside of the GATT have often included financial compensation as part of a remedy for breach of international law. Finally, Article 1807:8 itself speaks of compensation.

It must be acknowledged, however, that "compensation" in GATT terminology has had a particular meaning and has not been taken to mean payment of compensatory damages. A contracting party is obliged to compensate another by reducing barriers to trade that are equivalent to the trade that has been restricted.

This form of compensation may be adequate so long as there is a flow of trade. There could be cases, however, – the investment case is one – where there is no "flow" of transactions but on the contrary, simply one transaction that could be frustrated by government action inconsistent with the FTA. The problem is that a remedy which assumes a continual flow of transactions may be an empty one to a person whose single transaction has been thwarted by FTA-inconsistent governmental action. That could be Canco's situation in this case.

Given that there is nothing on the face of Article 1807 which requires that the restricted meaning of compensation in the GATT necessarily be extended to dispute settlement under the FTA, it is not beyond the realm of possibility that a panel might decide that a breach of the Agreement could only be remedied by damages payable to the injured person. Any question of damages would have to be approached with great care. Immediately a host of considerations arse. What about causation? In a case like the Canco case, there could be other factors that contributed to the bid's failure. To what extent would the Governor's statements contribute to the defeat of the takeover bid? Assuming the causation hurdle was crossed, what measure of damages would be appropriate? Lost expenses in making the takeover bid? Lost commercial opportunity? And, given that the panel's decision could be in recommendatory rather that binding form, questions about enforceability would arise.

Conclusion

This paper has provided a brief overview of the general dispute settlement procedure and has provided a hypothetical case by which to illustrate them. The case raises more questions that it answers. What it does suggest is that some matters (by no means all) addressed by the FTA may not be suitable for the protracted nature of international trade dispute resolution. It may be that the Parties themselves will respond to this as they feel their way into the new era of a bilateral treaty-based trading relationship. For students of international law, the evolution of the general dispute settlement procedures will be a fascinating process to watch.

Resolving Disputes under the Canada-US Free Trade Agreement: Comments on Chapter 18

Stewart Abercrombie Baker[*]

Chapter 18 of the Canada-US Free Trade Agreement (FTA) sets the framework for a wide range of dispute settlement techniques. It has the potential to be far-reaching and substantially more important than the specialized dispute settlement provisions of Chapter 19, which relates entirely to antidumping/countervailing duty law. Despite its potential importance, Chapter 18 has received less attention. So it was with pleasure that I reviewed Chris Thomas' thoughtful and imaginative discussion of issues that remain open under Chapter 18.

Professor Thomas begins with a familiar scenario: a nation accused of violating its trade obligations responds that dispute settlement is premature because the protectionist measure is still on the drawing boards. Once the measure takes effect, the nation agrees reluctantly to dispute settlement while taking full advantage of cumbersome conciliation and panel picking procedures. By the time a panel has declared the measure a violation of the country's trade obligations, much of the harm has already been done. But the only remedy is a promise that the offending state will revise its behaviour in the future, maybe even the near future.

Thomas raises the question whether such a scenario can be avoided under the FTA by an imaginative reading of its dispute settlement provisions. In particular, he asks three connected questions: (l) may a measure be the subject of dispute settlement when it has only been proposed? (2) if so, is some form of injunctive relief available at an early stage in the dispute?; and (3) are money damages available to those injured by measures that violate the FTA?

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[*] My thanks go to Ted Meisel, Stanford Law School, for his many thoughtful and substantive revisions to these remarks.

Because he believes that the answers to questions (l) and (2) are probably "no," Thomas suggests that perhaps the answer to question (3) should be "yes," at least in certain circumstances. In my view, however, we are more likely to make progress by rethinking questions (l) and (2) than by straining to award damages under the FTA. Let me take each question in order.

May a proposed measure be challenged under Chapter 18?

Article 2011 of the FTA allows a Party to seek Chapter 18 dispute resolution over any measure that "causes nullification or impairment of any benefit reasonably expected to accrue to that Party, directly or indirectly under the provisions of this Agreement ...." This provision does not expressly authorize dispute settlement over proposed measures. Rather, it is borrowed from Article XXIII of the GATT and may be infected with the GATT's reluctance to proceed formally against measures that are still merely contemplated.[1]

But if there are any such limitations in Article 2011, they are overwhelmed by the explicit language of Chapter 18. In the end, Article 2011 simply allows a Party concerned about nullification or impairment of FTA benefits to begin consultations under Article 1804 and then to proceed to dispute settlement under Articles 1805 and 1807 (or arbitration under Article 1806). But if one of the Parties wants to begin consultations under Article 1804, why not simply invoke that provision by itself? Article 1801 states that

> the provisions of ... Chapter [18] shall apply ... whenever a Party considers that an actual or proposed measure of the other Party is or would be inconsistent with the obligations of this Agreement or cause nullification or impairment in the sense of Article 2011 ... .

Article 1804 similarly seems to cover virtually any dispute that could have been brought under Article 2011: a Party may request consultation with regard to any measure "that it considers affects the operation of this Agreement ...." Article 1804 also expressly states that either Party may request consultations "regarding any actual or proposed measure." Thus a Party may begin consultations over measures that nullify or impair benefits under the FTA directly under Chapter 18 without first invoking 2011.

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[1] GATT Councils have been reluctant to proceed against proposed legislation, or an existing statute where pending legislation would alter it. See, e.g., "Italian Administrative and Statistical Fees," GATT Doc. C/M/59 (16 December 1969) noted in R. Hudec, *The GATT Legal System and World Trade Diplomacy* (New York: Praeger, 1975), pp. 226-27 (panel not formed while the Italian government considered tariff legislation). But see Panel Report, "U.K. preference on Bananas," GATT Doc. L-1749 (11 April 1962), noted in Hudec, pp. 217-18 (ruling in favour of Brazil against a proposed tariff increase under the UK margin-of-preference waiver).

Can a Party get the same relief if, to challenge a proposed measure, it takes the direct route through Chapter 18 and bypasses Article 2011? I think so. Under Article 1807(5), the dispute settlement panel is required to make a determination "as to whether the measure at issue is or would be inconsistent with the obligations of this Agreement or cause nullification and impairment in the sense of Article 2011...." This clause presents a problem of parallel construction: does the phrase "or would" in the first part of the sentence also refer to "cause nullification and impairment" in the second part? If it does apply, as I believe, then the clause authorizes panels to find that a measure "would cause nullification and impairment." "Would" adds nothing to the text unless it embraces contemplated actions. Thus, the FTA seems to allow panels to apply the "nullification and impairment" standard to proposed as well as to enacted measures.

Even if a Party proceeds under Article 2011, GATT practice suggests that effective relief may be possible before the other Party's measure takes effect. While GATT Councils have generally refrained from initiating proceedings against proposed legislation, established GATT practice permits panels to consider statutes that have been enacted but not yet applied.[2] The panel first considers whether "there is an infringement of the obligations assumed under the General Agreement." If so, "the action is considered *prima facie* to constitute a case of nullification or impairment."[3] Where there is not a *prima facie* violation, a GATT panel may issue guidelines defining the contours of enforcement measures which may be taken consistent with the GATT – a kind of declaratory relief.[4] Either way, the result is the same: measures that would conflict with GATT obligations are declared illegal before they are applied. Issuing a "guidelines" ruling on the potential enforcement of a statute may be a workable solution for a FTA panel faced with proposed legislation. The repeated references in Chapter 18 to proposed measures, contrasted with their absence from the GATT, suggest that FTA dispute settlement panels are authorized to take this step.

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[2] See Panel Report, "United States, Taxes on Petroleum and Certain Imported Substances," GATT Doc. L/1175 (17 June 1987) (considering import taxes to take effect in 1989), reprinted in Contracting Parties to the General Agreement on Tariffs and Trade: *Basic Instruments and Selected Documents* [hereinafter GATT: BISD], 34th Supp., pp. 159-64. See also Panel Report, "United States, Prohibition of Imports of Tuna and Tuna Products from Canada," GATT Doc. L/5198 (22 February 1982), reprinted in GATT: BISD 29th Supp., pp. 103-06; Panel Report, "Japanese Measures on Imports of Leather," GATT Doc. L/5623 (15 May 1984), reprinted in GATT: BISD, 31st Supp., p. 113.

[3] "Agreed Description of the Customary Practice of the GATT in the Field of Dispute Settlement," Annex to the 1979 "Understanding on Dispute Settlement," GATT Doc. MTN/FR/W/20 at 2/10, reprinted in GATT, BISD, 26th Supp. , p. 216.

Is some form of interim relief available early in a Chapter 18 dispute?

Interim injunctive relief may also be available from a panel established under Chapter 18. The FTA only hints at this, but the hints are strongest for investment disputes. Article 1608 states that investment disputes will be settled pursuant to Article 1806 or 1807 but that "the panel shall take into consideration how such disputes before it are normally dealt with by internationally recognized rules for commercial arbitration." There are a limited number of internationally recognized rules for commercial arbitration. Perhaps the most widely recognized (if not yet the most widely used) are those of the United Nations Commission on International Trade Law (UNCITRAL). Article 26 of the UNCITRAL arbitration rules states:

> At the request of either party, the arbitral tribunal may take any interim measures it deems necessary with respect to the matter of the dispute, including measures for the conservation of the goods forming the subject-matter in dispute, such as ordering their deposit with a third person or the sale of perishable goods.

This article has been applied with some frequency by the Iran-United States Claims Tribunal, which has issued several interim "requests" to both the US and Iranian governments. The requests have included instructions not to sell property claimed by the other government[5] and not to permit litigation in areas within the Tribunal's jurisdiction.[6] Though styled as "requests," the Tribunal has made it clear that they are in fact orders.

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[4] Panel Report, "United States, Taxes on Petroleum and Certain Imported Substances," GATT, BISD, 34th Supp., pp. 163-64.

[5] Behring International Inc. v. Islamic Republic Iranian Air Force, Award No. ITM 25-382-3, 2 Iran-US C.T.R. 173 pp. 174-75 (10 August 1983).

[6] Concurring Opinion of H. M. Holtzmann and R. M. Mosk, p. 7 (9 February 1983) to E-Systems Inc. v. Islamic Republic of Iran, Award No. ITM 13-388-FT, 2 Iran-US C.T.R. 51 (4 February 1983). The Iranian arbitrators never agreed with this position. They preferred to base an interim order on the "inherent powers" of the Tribunal, when they agreed to interim measures at all. See Concurring Opinion of M. Kashani, S. Shafeiei and J. Sani, p. 2 (16 March 1983) in the same case. For a comprehensive analysis of these positions by a behind-the-scenes participant, see D. Caron, "Interim Measures of Protection: Theory and

Other commercial arbitration rules also make provision for interim relief. ICSID rule 39(1) states that a tribunal, at its own initiative or that of a party, may "recommend" provisional measures for the preservation of the rights of one or more of the parties. Article 13.1(h) of the London Court of International Arbitration (LCIA) gives the court the power to "order the preservation, storage, sale or other disposal of any property or thing under the control of any party." Article 8(5) of the International Chamber of Commerce Arbitration Rules permits the parties "to apply to any competent judicial authority for interim or conservatory measures" without risk of breaking the arbitration agreement.

Given the precedent established under the UNCITRAL rules and the language of other arbitral rules, it seems to me that a dispute settlement panel might be willing to issue an interim order preventing enforcement of a measure that directly violates the FTA. Presumably, the standards for issuing an order would be similar to the standards for issuing injunctions: a showing of probability of success on the merits[7] and a weighing of the likelihood of irreparable harm to one side or the other if the measure is suspended while dispute settlement goes forward.[8]

Can such relief be granted outside the context of investment disputes? Only Article 1608 makes direct reference to commercial arbitration rules, so the option of granting interim relief is arguably available only to panels hearing investment disputes. I note, however, that Article 1807(4) requires each dispute resolution panel to "establish its rules of procedure, unless the Commission has agreed otherwise." This language could open the door to interim relief in all dispute settlement proceedings, unless the Commission excludes such relief.

Practice in Light of the Iran-United States Claims Tribunal" (1986) 46 *Zeitschrift fur Auslandisches Offentliches Recht Und Volkerrecht*, pp. 499-500.

[7] This is more of an unspoken requirement in public international arbitration than the expressly required factor it is in domestic courts. See Caron, "Interim Measures of Protection: Theory and Practice in Light of the Iran-United States Claims Tribunal" (1986) 46 *Zeitschrift fur Auslandisches Offentliches Recht Und Volkerrecht*, pp. 490-91.

[8] In international arbitrations, the irreparable harm standard may be easier to satisfy and may encompass the stay of parallel judicial proceedings. Caron, "Interim Measures of Protection: Theory and Practice in Light of the Iran-United States Claims Tribunal" (1986) 46 *Zeitschrift fur Auslandisches Offentliches Recht Und Volkerrecht*, pp. 491-97.

Are money damages available under Chapter 18?

Even assuming that panels can review measures while they are still proposals and that interim relief is available, private parties will still be injured while awaiting a panel decision. It will typically take at least 60 days simply for the parties to consult and then choose a panel. Even this much delay might kill a tender offer, bringing us to the question of whether damages can be awarded to the disappointed suitor. Chris Thomas takes the view that an award of damages for violations of the FTA "is not beyond the realm of possibility." Maybe not, but it is surely on the outer border of that realm. Under Article 1807(8), once the Commission receives the panel's report and recommendation it has a choice of two remedies: (1) "non-implementation or removal" of the offending measure; and (2) "failing such a resolution, compensation." Even if one were prepared to strain the accepted trade law meaning of "compensation" to include private damages, compensation is available only if the dispute cannot be resolved through nonimplementation or removal of the measure at issue. Cases in which the measure cannot be removed will be (or at least ought to be) rare; and those cases will be the most politically sensitive, hardly the best occasions for adopting a bold new approach to compensation.

If I were forced to write a brief in favour of damages under Chapter 18, I would argue that "removal of a measure not conforming with this Agreement" may include removal of the adverse effects of the measure. In a proper case, this might mean making whole those parties injured by the measure.

If such an argument were to succeed, a host of difficult issues would arise, not the least of which is who would pay the damages. If the state of Ohio enacts the offending statute, presumably Ohio will pay the damages. I would be surprised, however, if Ontario would meekly pay damages to California wine makers just because a panel appointed by Ottawa and Washington holds that Ontario's wine selling practices violate the FTA. Even under the weak form of federalism in effect in the United States, awarding damages against a state raises constitutional questions under the 11th amendment to the US Constitution (a little-known amendment on which I happen to have written a few articles of excruciating length). In brief, the 11th amendment often (but not always) bars the award of damages in federal courts against state governments.[9] There is, however, an exception for suits brought by the federal government itself.[10] This brings me to the final issue on which I would like to comment.

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[9] Florida Dept. of State v. Treasure Salvors Inc., 458 US 670 at 689-90, 102 S.Ct. 3304; Edelman v. Jordan, 415 US 651 at 663, 94 S.Ct. 1347 (1974).

[10] United States v. Mississippi, 380 US 128 at 140-41, 85 S.Ct. 808 (1962).

How will dispute settlement decisions be enforced against states?

The US federal government has unquestioned power to preempt state and local laws that conflict with the FTA. What is interesting is how that power has been exercised in the implementing legislation. Section 102(b) of the Canada-US Free Trade Agreement Implementation Act of 1988 provides that "the provisions of the Agreement prevail over – (A) any conflicting State law ... to the extent of the conflict."[11]

If Congress had enacted only that language, private litigants from all across the United States would be free to file suits against any state measures deemed inconsistent with the FTA. The self-interest of American litigants would have been a powerful engine for enforcement of the FTA. But Congress did not go that far. Instead, the implementing legislation empowers the US government, and presumably only the US government, to "bring an action challenging any provision of State law ... on the ground that the provision or application is inconsistent with the Agreement."[12]

This provision has an interesting separation-of-powers dimension. The courts will be brought into the matter only when the Executive branch believes that preemption is required. Given the usual judicial deference to the Executive in foreign affairs, the Executive's interpretation of the FTA will rarely be rejected when it files suit. If private parties were free to bring preemption claims, in contrast, the courts would often be forced to construe the FTA without the benefit of the Executive branch's views. These judicial constructions would quickly acquire a life of their own, with the result that Executive branch discretion in interpreting the FTA would be dramatically limited. The implementing bill thus preserves a good deal of interpretative discretion for the president.

Perhaps more important from Canada's point of view, the provision also reserves the president's discretion about whether, when, and how to enforce the FTA. The authority to sue states for violation of the FTA is "intended to be used only as a 'last resort.'"[13] At a minimum, enforcement actions will be undertaken against states only if the Canadian government shows a willingness to be equally tough with the provinces. The drafters of the implementing legislation promised that, before filing suite against a state,

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[11] H. R. Doc. 216, 100th Cong., 2d Sess. 47-48 (1988).

[12] H. R. Doc. 216, 100th Cong., 2d Sess. 47-48 (1988).

[13] Statement of Administrative Action at 7; reprinted in H. R. Doc. 216, 100th Cong., 2d Sess. 169 (1985).

> the Attorney General would consider the advice of the Trade Representative as to whether the Canadian Government had objected to the state measure in question and the extent to which Canada was taking necessary measures to assure conformity of Canadian provincial measures with the FTA.[14]

In short, the US government has the power to enforce both the FTA and any panel decisions interpreting the FTA. But how and when the president will use that power may prove to be a matter with considerable diplomatic – and even political – content.

It is a great temptation to run on until my comments are longer than Chris Thomas' thought-provoking discussion. I will close by noting that his paper represents precisely the sort of bold and imaginative thinking that the Centre for Trade Policy and Law in Ottawa has been established to promote. I look forward to hearing more from him as the dispute settlement provisions of the FTA sort themselves out.

Chris Thomas Replies[15]

Had my paper expressed the views noted by Stewart Baker, I too would have felt constrained to take exception to them. I leave it to the reader to judge who is right.

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[14] Statement of Administrative Action at 7; reprinted in H. R. Doc. 216, 100th Cong., 2d Sess. 169 (1985).

[15] Editors' Note: During the course of the conference, many of the presentations in this volume were followed by comments and questions and answers. Stewart Baker's comments on Chris Thomas' paper were the most detailed and controversial. We decided, therefore, to reproduce them in this volume and also give Chris Thomas an opportunity to reply.

III.

Working Under the New Regime

The FTA Rules of Origin: Boon or Boondoggle?

David Palmeter

The rules of origin are perhaps the most important, the most complex and, potentially, the most contentious provisions of the Canada-US Free Trade Agreement (FTA). Whether they are a boon or boondoggle is a matter of perspective. Certainly the FTA negotiators thought the rules to be a boon to the businesses that send goods across the border.[1] But the complexity of the rules may well result in their being more of a boondoggle than a boon for businesses. Should this be the case, all would not be lost, for the rules would then be a boon for us lawyers.

The rules of origin are set forth in Chapter 3 of the Agreement, and in an extensive annex to that chapter. While the chapter is indeed entitled Rules of "Origin," more accurately from the US perspective, it might have been called Rules of "Preference." This is because the chapter merely sets out the rules that will govern the granting of duty-free or reduced-duty treatment, and not whether, for other purposes, a product necessarily originates in Canada.

This is an important – if not widely appreciated – point: an article may enter the United States from Canada, fail to meet the requirements of Chapter 3 of the FTA and, therefore, not receive preferential treatment. Nevertheless, it may be a "product of Canada" for all other purposes, such as country of origin marking, rate of duty or quotas. The basic US rule of origin – the

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[1] Simpson, "Reforming Rules of Origin," *Journal of Commerce,* Oct. 4, 1988, p. 12A.

"substantial transformation" test – applies every bit as much to Canada today as it did before the FTA came into force.

In most instances, to be sure, processes sufficient to confer preferential treatment under the FTA will be sufficient to confer origin under the substantial transformation test. In most instances, accordingly, distinctions between the FTA's rules and the substantial transformation test will be irrelevant. But in a number of instances, the distinctions will have important consequences, and those businesses whose trade is affected are likely to look upon the FTA rules as more of a boondoggle than a boon.

A far from exhaustive perusal of the FTA rules[2] reveals a number of examples of processes that do not confer preference under the FTA, but do confer origin under the substantial transformation test:

- tailoring cut pieces of apparel into a finished article[3]
- programming an EPROM semiconductor[4]
- galvanizing full-hard cold-rolled sheet by a continuous hot-dip process[5]

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[2] As discussed in the text of this paper, these rules are set out in detail in Annex 301.2 of the FTA.

[3] Pieces of apparel are classified either under HTS 6117.90.00 (if knit or crocheted) or under HTS 6217.90.00 (if not knit or crocheted). The finished knit or crocheted article would be classified elsewhere in HS Chapter 61 and the finished woven article (i.e., not knit or crocheted) in HS Chapter 62, depending upon the exact nature of the finished article and its fibre content. Accordingly, the assembly operation would never result in the FTA's requisite chapter change, nor would the other criteria of rules 14 and 15 of Section XI be satisfied (i.e., that the goods must be both cut and sewn or otherwise assembled in the territory of either Party or both Parties). But, for other purposes, country of origin could change pursuant to US Customs Regulations which provide that an article will "usually" be the product of the country where substantial assembly takes place, even if the pieces were cut from fabric in a third country: 19 CFR S12.130(e)(u).

[4] Whether or not programmed, an EPROM (erasable programmable read only memory) semiconductor is classified under HTS 8542. Accordingly, programming (or reprogramming) will result in neither a chapter nor a heading change as required by rules 1 and 2 of Section XVI, nor would any of the other more specific Section XVI origin rules be satisfied. However, pursuant to Customs Service Decision 84-85 (Ruling No. 071306 dated April 2, 1984), programming confers origin.

[5] Ungalvanized cold-rolled sheet is classified under HTS 7209 or HTS 7211 depending upon its width. If galvanized, the cold-rolled sheet is classified under HTS 7210 or HTS 7212, again depending upon width. Accordingly, galvanizing the sheet will not result in the chapter change required by rule 1 of Section XV, nor will it satisfy the other relevant rule (i.e., rule 3, that a change to headings 7208-7216 from any other heading outside the group confers origin). However, Ferrostal Metals Corp. v. US, 664 F. Supp. 535 (Ct.

- cutting and polishing rough gemstones[6]
- processing, freezing and packaging fish.[7]

Products subject to the FTA rules of origin can be divided into two classes: those that originate entirely in either country, and those that are produced in either country utilizing materials or components imported from a third country. There is little likelihood of a problem for goods that originate entirely in either country. Article 301.1 provides that goods originate entirely in Canada or the United States if they are "wholly obtained or produced" in the territory of either or both countries. The term "wholly obtained or produced" is defined in Article 304 to include minerals, agricultural and fish products, as well as goods taken from the sea bed or returned from outer space.

When goods are produced in either country utilizing third-country materials or components, however, more difficult issues of origin arise. The FTA employs a "change in tariff heading" system to determine origin when goods are produced in either country utilizing imported materials. A product will be deemed to originate in the territory of Canada or the United States if the production process utilizing third-country materials is sufficient to change their tariff classification under the Harmonized Commodity Description and Coding System, commonly called the Harmonized System (HS). Additionally, the FTA provides that in some cases goods shall be considered to have been transformed sufficiently in the territory of either of the Parties, even if their tariff heading is not changed, if the value of the materials originating in the territory of either Party plus the direct cost of assembly constitutes at least 50 per cent of their value when exported.

This system for determining origin – or preference – is very different from the substantial transformation test applied in the United States. A substantial transformation occurs when a "new and different article ... emerges from a

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International Trade 1987), held that galvanizing indeed did substantially transform steel sheet so as to change its country of origin.

[6] Pearls, diamonds, precious and semiprecious stones, whether or not worked on, are classified under HTS 7101, 7102, 7103 and 7104, respectively. Accordingly, cutting and polishing these stones results in neither a chapter change nor a change to headings 7113-7118 as required by rules 1 and 2 of Section XIV, and, therefore, origin does not change for FTA purposes. However, US Customs Ruling No. 071067, dated 2 December 1982, holds that the cutting and polishing of a gemstone is a process which changes its country of origin.

[7] Fish meat, whether fresh or processed and frozen, is classified in Chapter 3 of Section I of the HS. Accordingly, processing does not result in the chapter change required by the rule in Section I. The US Court of International Trade, however, found that such processing did confer origin for duty and marking purposes in Koru North America v. US, Slip Op. 88-162 (23 November 1988).

manufacturing process with a name, character, or use which differs from those of the original materials subjected to the process."[8] The FTA negotiators considered this rule to be too subjective, too inconsistent in the results it produced and too vulnerable to political pressure.[9] The FTA rules are said to avoid these problems.

At a general level, the FTA rules are simply stated: goods originate in the territory of either Party if they are wholly obtained or produced there; if they are transformed sufficiently there from third-country materials; or, for specified assembly operations, if adequate value is added. Additionally, customary quantities of accessories, spare parts or tools have the same origin as the equipment, machinery, apparatus or vehicle with which they are delivered. Even if the criteria for origin are otherwise met, a good does not originate in the territory of either Party by virtue of having undergone simple packaging or combining operations, dilution with water or other substances that do not materially alter its characteristics, or by virtue of any process undertaken simply to circumvent the FTA rule.

A transshipment rule requires that goods be shipped to the territory of the other Party without entering the commerce of any third country and, if shipment is through a third country, that their documents show the territory of the importing Party as their final destination, and that only necessary loading, unloading and transport operations take place in the third country. This provision would operate to deny US origin for FTA purposes to goods subject to final assembly in the various "maquiladora" operations on the border with Mexico – a point that was important to Canada in the negotiations.

When preferential origin depends upon whether the value of materials originating in either Party plus direct cost of assembly equals 50 per cent, an interesting point arises concerning the value of the materials: what if the materials themselves are produced from imported materials? This might occur, for example, if imported steel is fabricated into a component for a machine. What value should be used to determine whether the machine meets the 50 per cent value requirement when exported: the full cost of the component, or its cost less the value of the imported steel?

According to Article 304, the value of materials originating in the territory of either or both Parties includes the price paid by the producer of the exported good "for material imported from a third country used or consumed in the production of such originating materials." Thus, the full cost of the component should be included, with no deduction for the value of the imported steel. But the extent to which the imported materials must be "used or consumed" in the production of the originating materials is not specified. In particular, it is not specified whether the imported materials must be transformed into the originating materials to the degree necessary to qualify for the FTA preference themselves. In other words, does it make a difference if the operations necessary to make the machine component from the imported steel were or were not enough to confer FTA preference on the components? The FTA does not say.

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[8] Anheuser-Busch Brewing Association v. United States, 207 US 556 (1908); Torrington Co v. United States, 764 F.2d 1563 at 1568 (Fed. Circ. 1985).

[9] Simpson, "Reforming Rules of Origin," *Journal of Commerce*, Oct. 4, 1988, p. 12A.

Here the retention by the United States of the substantial transformation test for other purposes becomes a factor. If a US producer of "originating" materials substantially transforms imported materials in their production, the originating materials are a product of the United States for US marking and labelling purposes, even if the substantial transformation process does not meet the criteria for origin under the FTA.[10]

A producer of exported goods, purchasing originating materials from an unrelated supplier, may be totally unaware of their foreign content. At the level of imported materials "used or consumed" in producing originating materials (imported steel used to produce a machine part), tracing may be difficult if not impossible. Thus, in practice, the rule for such "internal" transformation is likely to be the basic rule of origin of the country concerned. In the United States, this is the substantial transformation test.

Despite the fact that, at a general level, the FTA rules may be stated simply, the heart of the rules lies not in their general statement, but in a detailed annex to Chapter 3: Annex 301.2. In the 21 sections that incorporate the 97 chapters of the Harmonized System, the 20 pages of the annex specify precisely what classification changes must occur in order to change the origin of imported materials.

The rules for the first and last of the 21 sections are the simplest: Section I, covering the first five chapters, concerns live animals and animal products. Here the rule which will confer FTA origin is a change in classification from one chapter to another; a change in classification that occurs within one of the five chapters will not confer origin. Thus, according to the FTA rule, if beef (Chapter 2) is miraculously transformed into fish (Chapter 3), a change in origin will indeed result. But if fresh milk is turned into aged cheese (both Chapter 3), origin will not change. The rule for Section XXI, covering works of art, collectors' pieces and antiques, is also simple. It provides that FTA origin will be conferred by a change to its single chapter (Chapter 97) from any other chapter of the HS.

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[10] 19 USCA, Section 1304 (a).

Here we might have hit upon the ultimate loophole. Chapter 97 provides that anything more than 100 years old is an antique.[11] Thus, if an FTA duty preference cannot be achieved in any other way, the best strategy might simply be to wait; after 100 years, everything becomes classified in Chapter 97, thus accomplishing the required change in classification to Chapter 97 from any other chapter. Admittedly, this strategy is likely to have limited utility if the product involved is, say, fresh fish.

Sections I and XXI, however, offer the simple examples. In the 19 sections and 91 chapters between Section I and Section XXI, the specific operations that confer origin cannot be articulated as a general rule or principle. Instead, each section must be studies separately, chapter by chapter, indeed item by item, to determine what specific operations are required to confer origin on specific products. At this point there is no single rule of origin or preference, but literally hundreds of separate rules, by conservative count, at least 1,498 of them.

Decisions concerning eligibility for preference under the FTA will not, therefore, be made on the basis of broad principles, but on the basis of the minutiae of the hundreds of pages and thousands of lines of the Harmonized System. Decisions will be made not so much by policy makers, but by technicians, for it will be the rare policy maker who will spend more than a few moments amidst the arcana of the Harmonized System or any other system of tariff nomenclature.

This is viewed as a positive development by many trade officials in the United States. US Trade Representative Carla Hills, for example, advocates a similar rule of origin – or preference – for the US program that extends preferences to Caribbean Basin nations. According to Ambassador Hills, exporters "will find such an approach more predictable and transparent than the present system based on less objective determinations concerning findings of substantial transformation."[12] Perhaps. But predictability and transparency are not all that might evolve from the adoption of such a system. Protectionism might evolve as well.

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[11] HTS No. 9706.00.00 includes "Antiques of an age exceeding 100 years."

[12] See "Administration Statement By Ambassador Carla A. Hills on H.R. 1233, The Caribbean Basin Economic Recovery Expansion Act of 1989," submitted to Subcommittee on Trade, Committee on Ways and Means, US House of Representatives (31 March 1989), p. 10.

Annex 301.2 of the FTA is an example of how this might happen. Take, for example, the oft-cited fact that fresh milk is not transformed for FTA purposes when it is made into cheese. This, no doubt, reflects primarily the fact that the Harmonized System is designed to deal with product classification rather than to itemize operations significant enough to confer origin. But it is likely that the result also meets with the approval of the dairy industries on both sides of the border. It was, after all, allowed to stand as an example of the inadequacy of the HS to deal competently with questions of origin.

Numerous similar anomalies were not allowed to stand. But in order to avoid them, the FTA drafters were forced to include some 20 mind-numbing pages of detail that lack any organizational rationale, theme or principle. Annex 301.2 is essentially a response to the technical difficulties that result from utilization of a tariff nomenclature not designed with origin in mind, leavened with a large number of political deals and accommodations.

Those political deals and accommodations are reflected in many of the 1,498 separate rules of origin that are spread among the 20 pages of Annex 301.2. Clearly, these detailed rules of tariff classification were written with industry representatives at the elbows of the negotiators. Presumably, since this was a negotiation, any attempt by an industry on one side of the border to "put one over" was thwarted by its opposite number on the other side. In this event, there may be no losers – other than consumers, if there are more "sweetheart" agreements of the milk and cheese variety yet to be unearthed.

The descent of rules of origin determinations from general principles of law, such as substantial transformation, into the details of tariff classification, would seem to offer continuing opportunities for industry "specialists" to urge their views at the technical levels of government, well out of the range of policy makers. In the day-to-day decisions, the triumph of the technicians may well mean the triumph of those with a special interest in the product at hand. Rarely will anyone else have sufficient command of the details to enter significantly into the resolution of problems in the area.

This will not always be the case, however, for tariff classification issues sometimes do rise to the policy level – as anyone familiar with the debate in the United States over whether a van is a truck or a car will attest,[13] as will

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[13] See, "When Is a Truck a Truck" *Washington Post* (22 February 1989), p. 16; "If it Quacks Like a Truck, It's a Truck" *Washington. Tariff & Trade Letter* (20 February 1989), p. 3.

Canada's sugar refiners who are protesting a change in tariff classification of blended sweeteners.[14] But of course, the prominence of these issues itself attests to the fact that tariff classification disputes are no more immune from political influence than are substantial transformation disputes or disputes concerning other determinations by Customs officials that have an economic impact on producers in an importing country.

Moreover, and perhaps of more concern, political impact can be felt apart from issues such as vans and blended sweeteners that make their way to the front pages of the newspapers. Most of the time, the political influence will likely occur with less prominent products at far lower levels of visibility.[15]

Maybe, as their drafters and defenders contend, the FTA rules are neutral, objective and transparent; maybe their implementation will be the customs equivalent of heaven on earth. Maybe. But maybe things will not work out that way; maybe arbitrary decisions will proliferate in the bureaucratic dark; maybe widespread confusion will ensue.

This would be a boondoggle for business; but as stated at the outset, it would be a boon for lawyers. What, after all, could be a better description of the customs equivalent of heaven on earth for lawyers than the replacement of a single rule of origin by at least 1,498 different rules?

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[14] See, "Canadian Sugar Refiners Voice Opposition to U.S. Customs Tariff Change o Sweeteners" (1989) 6 *International Trade Reporter*, p. 176.

[15] See e.g., "Tariff Classification of Wire Rope With Becket Attachments" 53 Fed. Reg. 4911 (6 December 1988) (reclassification of wire rope fitted with particular attachments from tariff category not subject to quotas into a category subject to quotas, previously, whe quotas were not at issue, the product was classified in the category with the higher duty

New Rules, New Institutions: The CITT

John Coleman

It is a pleasure to see the Canadian International Trade Tribunal (CITT) mentioned under the same heading as free trade. Just the same, there is a tendency for conference organizers to see the CITT as an emanation of the Canada-US Free Trade Agreement (FTA) rather than as an aspect of the trading system in general. This tendency seems only natural when one recalls that the CITT began operations on December 31, 1988, one day before the bilateral free trade agreement came into force.

In the last few months, I have spent a fair amount of time explaining that the CITT or something like it would exist even if the FTA had not become a reality. In the struggle for money and staff to help create a first-class institution, however, I confess not to have been inclined to correct the general assumption that we were a creature of the FTA and therefore deserved top priority! To help you understand where the balance lies, I would like to touch on the following three topics:

- The CITT's Origins and Programs
- CITT Innovations and FTA Links
- The CITT's Current Activities and Future Directions.

The CITT's Origins and Programs

The Canadian International Trade Tribunal has replaced three institutions: the Canadian Import Tribunal (CIT), the Tariff Board (TB) and the Textile and Clothing Board (TCB). The CITT took over most of their inquiry and appeal functions and it was given some important new powers. It is more than the sum of its predecessors.

I have included as an Annex a note which describes the Tribunal's organization and programs. The main points to mention here are these: the Tribunal is an independent, quasi-judicial agency not connected to any other department of government, although it reports to Parliament through the Minister of Finance; it has nine members and a staff of about 80, of which half work in research and the rest in legal services, registry functions and administration.

The Tribunal has taken over the work of the CIT in antidumping and countervailing duties injury inquiries and of the Tariff Board in appeals from Revenue Canada, Customs and Excise decisions. It has assumed the GATT Article XIX import safeguard inquiry work of both the CIT and the TCB. In this connection, the CITT has the new power to conduct such inquiries not simply at the request of the government but also of Canadian producers. The Tribunal has inherited the Tariff Board's work of conducting safeguard inquiries requested by Canadian producers affected by Canada's General Preferential Tariff (GPT) for developing countries or duty-free access for the Commonwealth Caribbean countries under CARIBCAN. Finally, the Tribunal has acquired in a strengthened form the powers of its three predecessors to inquire into any economic, trade and tariff question referred to it by the government.

The idea of amalgamating the three trade-related institutions had existed for at least a decade before it was acted upon. It was the "Nielsen" Task Force on Program Review which made the matter a live issue. The government announced in the 1985 Budget its intention to develop legislation to combine the three bodies. The legislation, Bill C-110, was tabled in February 1988 and received royal assent on September 13, 1988 as the Canadian International Trade Tribunal Act.

The government's original purpose in amalgamation was "good housekeeping." The three institutions were seen as having overlapping functions, particularly in their trade and economic inquiry work. Each was small in scale and could afford little specialization in its research functions, or depth in its administrative and legal services.

In particular, the future of the Textile and Clothing Board seemed clouded. With the progressive expansion during the 1980s of the Multifibre Arrangement and the development of a network of bilateral restraint arrangements administered by External Affairs, the TCB's injury inquiry functions were hardly being used. The Board turned its attention more and more to the collection of statistics and the drafting of sectoral studies. Questions were raised whether it was useful to maintain an import institution devoted to the problems of only two industries. At the same time, ministers considered that any legislation to merge the three institutions should be designed to preserve their key facilities, including those of the TCB.

Two main issues were debated within the government before Bill C-110 was tabled. One issue was whether, in import safeguard cases, the Tribunal should be given the power to initiate an inquiry not simply on direction from the government but also at the request of Canadian producers complaining about serious injury from imports.

Some considered that the government should retain the sole power of initiative because of the need to manage Canada's overall trade relations. Those holding this view feared a plethora of producer-requested inquiries leading to findings of serious injury by the Tribunal. Where the Tribunal found serious injury there would be enormous pressure on the government to take GATT Article XIX action against imports from all sources, thus inviting the payment of compensation or retaliation and putting at risk our export industries.

The contrary view, which prevailed, was that direct access for Canadian producers would be no more difficult for the government to manage than it is for the US Administration under section 201 of the Trade Act of 1974, which grants such facilities to American producers. Direct access for serious injury inquiries was already available in Canada through the Textile and Clothing Board, but only for two industries. A direct access facility could be designed to weed out frivolous cases before they reached the inquiry stage. In any event, the government would retain full freedom of choice on whether or how to respond to any finding of serious injury by the Tribunal, be it by border action, adjustment assistance or delay!

The other issue which received considerable attention before the tabling of the legislation was whether the new Tribunal should retain the Tariff Board's appeal functions relating to decisions of the Minister and Deputy Minister of Customs and Excise, or whether these should be transferred to an enlarged Tax Court. The Department of Justice had been considering legislation to bring all tax appeals under one roof, including those in the customs and excise field.

One view was that the Tariff Board appeal functions were of a more judicial and less trade and economic nature than would be the bulk of the new Tribunal's functions. Accordingly, it would make sense to consolidate all tax appeals. Another view was that the Tariff Board had developed over many years an effective "court of easy access" approach to its appeals work which the business community and general public appreciated. There was felt to be a risk of "over-judicialization" of this work if it were transferred to the Tax Court. In the event, the legislative calendar settled the issue; the Department of Justice preparation of revised Tax Court legislation was not sufficiently advanced by early 1988 to permit the transfer of the Tariff Board appeal work. Bill C-110 provided, therefore, that this work should be given to the new Tribunal.

It always will be possible for the government to re-examine this matter some day, taking into account how both the Tribunal and the Tax Court develop. Such a review could also take into account experience with the Harmonized System of Tariff Nomenclature and the development of a national sales tax system, both of which will presumably reduce the number and complexity of customs and excise tax appeals.

In tabling Bill C-110, the government made it clear that the legislation was not related to the Canada-US free trade bill, except in a technical sense. That is, references in the FTA legislation (Bill C-130) to antidumping and countervailing duties injury inquiries and findings of the Canadian Import Tribunal would apply to the CITT if Parliament passed both pieces of legislation. Both opposition parties accepted the distinction between Bill C-110 and Bill C-130. They supported the principle of Bill C-110 and cooperated in its passage, subject to a couple of detailed amendments.

The legislation had been introduced as a housekeeping measure and, because of the heavy end-of-session agenda, might well not have received passage before the election writs were issued. Its passage reflected a general recognition that, Canada-US free trade or not, for the sake of its bilateral and multilateral interests, Canada required the strongest possible trade remedies and inquiries institution.

CITT Innovations and FTA Links

In terms of programs, the CITT has strengthened powers in two areas, compared to its predecessors. These are first, direct access inquiries resulting from import safeguard complaints by domestic producers and secondly, more explicit powers for general economic, trade and tariff inquiries.

As far as the Canada-US Free Trade Agreement is concerned, there are two main legislative implications for the Tribunal. One is the possibility of Chapter 19 review by binational panels of Tribunal antidumping and countervailing duty injury findings concerning US goods, as an alternative to appeals to the Federal Court of Canada.

The second concerns safeguard inquiries. Under the provisions for safeguard actions undertaken either at the request of the government or producers, US goods can be excluded under certain conditions. In addition, a special bilateral safeguard mechanism was created with respect to possible serious injury resulting from reductions in tariffs under the FTA.

While these legislative changes are important, of equal interest are the policy issues which are connected to them. I would like to discuss both aspects with reference to the areas identified above.

Direct Access Safeguard Inquiries

The government, in deciding to proceed with a direct access facility, took the view that it should be designed to ensure that only well-founded cases would be accepted. This resulted in drafting designed to weed out less serious cases. The concept of a producer filling out a "properly documented complaint" was borrowed from the Special Import Measures Act (SIMA). In addition, the producer making the complaint was to represent a "majority" of the industry, and the serious injury from the imports of the like or directly competitive goods was to be the "principal" cause of the injury.

The Parliamentary debate showed that the direct access provision was popular with all parties. The concern was whether the government had taken the principle far enough and, in particular, whether the concepts of a "majority" of the industry and of "principal" cause were not too limiting.

In the House Committee, the government agreed to an amendment to change a "majority" to a "major proportion." This is the minimum standard required under the GATT and under US law, and has been shown through case law to be less than 50 per cent and to involve something in the range of 25 to 45 per cent of an industry.

While an amendment was proposed to replace the term "principal" cause with the American term "substantial," the government resisted this change on the grounds that in practice the two terms were defined the same, that is, as a cause "no less important than any other cause."

The government also did not accept amendments which would have required it to take a decision within a certain time limit in response to any serious injury finding by the Tribunal. This means that the government retains discretion at the end of the day to delay action or take no action at all to redress the injury if it considers that other objectives, including Canada's overall trade interests, would not be well served by such action.

At this stage, it is difficult to tell what use will be made of the direct access provision and what effect it will have on Canada's trade policy and trade relations if it is used and serious injury findings are made by the Tribunal. So far no cases have emerged. The explanation for this is probably the brief existence of the Tribunal and the fact that economic conditions have been reasonably buoyant, causing fewer industries to blame their problems on imports; the Tribunal, after all, works in a countercyclical industry. Time will tell what role direct access will play in the Tribunal's work and in Canadian trade policy generally.

General Trade and Economic Inquiries

One of the key objectives of the amalgamation project was to create some scale advantages, particularly with respect to the new Tribunal's research capacity. This would permit the Tribunal, among other things, to undertake more general trade, tariff and economic inquiries. The government had in mind the example of the US International Trade Commission which carries out research and, through public hearings, collects facts and opinions related to trade problems and policies.

In February, the Minister of Finance asked the Tribunal to conduct an inquiry and report by December 31, 1989 with recommendations on how the government could implement in detail its plan to reduce, over the next 10 years, Canadian textile tariffs to an average closer to the lower rates prevailing in the major industrial countries, including the United States.

The Textile Tariffs Inquiry has its origins in the FTA. It was the government's response to arguments of the clothing industry that its textile input costs had to be reduced if it was to compete successfully in a free trade environment. The inquiry will give all interested parties an opportunity to make their views known on the pace of tariff reductions for various products, on immediate tariff elimination or exceptions for certain products and on the economic effect of the proposed changes.

I am very pleased that the Tribunal has been given this reference. It allows the Tribunal, as an independent body, to demonstrate its comparative advantage, relative to the trade policy departments, in research capacity and in facilities for gathering facts and opinions through public hearings. The Tribunal will be allowed to demonstrate that in the future it can help the government and the private sector better understand and deal with structural adjustment issues related to implementation of the Canada-US FTA and of the Uruguay Round trade liberalization measures.

There is another FTA dimension to the Tribunal's general trade and economic inquiry powers. This is the possibility that the Tribunal may be asked to inquire into the alleged subsidizing of an American industry. This could occur if the Canadian industry producing the same product considers that the alleged subsidies are affecting its ability to compete, as tariff and other trade barriers are removed between the two countries. This issue arose during Parliament's consideration of Bill C-110, in response to the similar "Baucus-Danforth" provision which was added at a late stage to the American implementing legislation.

In response to the concerns of parliamentarians, the government explained that the general inquiry provisions of Bill C-110 would give Canada the same facilities as those of the United States through the Baucus-Danforth provision. The government agreed to forward to the CITT for inquiry all "reasonable" concerns raised by producers about subsidized American competition. The information collected by the Tribunal could be used by the complaining industry or Revenue Canada to initiate a countervailing duties investigation or the government could take other appropriate action, including use of section 59(2) of the Customs Tariff (the Canadian answer to the American "section 301").

It is still too early to tell if the Baucus-Danforth style provisions will be used on either side of the border. Perhaps, over time, they will be seen to be important mainly for having eased passage of the FTA legislation in both countries, rather than for their actual use.

Binational Panel Review

A key element of Chapter 19 of the FTA is the provision for review by binational panels of Revenue Canada determinations and Tribunal findings in antidumping and countervailing duty cases which concern American goods. Either country may request such a review as an alternative to a normal judicial review. If a binational panel review is not requested, regular judicial review, in Canada's case through the Federal Court, is available, as it continues to be for decisions involving goods of non-US origin.

Under the FTA, neither country has modified the substance of its antidumping and countervailing duties laws and practices. The binational panels are to apply the same standards of review as would be exercised by the courts of the two countries and they are to judge decisions by the law, practice and standards applying in each country.

One might ask then whether there will be any practical consequences for the Tribunal's work arising from the possibility of binational review of its decisions. The answer is probably yes, though it is difficult at this stage to say precisely how that practice will be affected. At time of writing, no Tribunal cases had yet been appealed to the binational panel.

There are three areas, however, which will bear watching and which may have implications for the Tribunal. The first arises from the fact that the binational panels will be looking not simply at the Tribunal's decisions but also at those of Revenue Canada. This is the counterpart of Canada's negotiating success in opening up US Department of Commerce decisions to binational review. There is a long-standing tradition of judicial review of the CITT's predecessors' decisions but, through the binational panel system, the FTA provides for a broadening of the grounds of appeal of Revenue Canada decisions.

There is a clear possibility that binational panels will overturn from time to time Revenue Canada decisions on questions such as the definition of a subsidy or the margins of subsidizing or dumping. This could have implications for the number of antidumping and countervailing duty cases which are initiated and for the number which reach the stage of injury inquiry by the Tribunal (the same effect may be observed in the United States and this, from a Canadian perspective, is a welcome prospect).

Apart from the possible effect of binational reviews on the size and nature of the Tribunal's work load, it will be interesting to observe whether over time there will be a tendency towards convergence in the standards and the practices of Revenue Canada and the US Department of Commerce.

The second area to watch will be the standards which the binational panels will apply to findings of the Tribunal itself. Under Canada's own system of judicial review, the Federal Court may review the Tribunal's findings to ensure that it has applied natural justice, has avoided mistakes in law and has not based its decision on any error of fact through capriciousness or disregard of material presented.

While the court has broad powers to look at the facts presented to the Tribunal, in practice it has not wished to substitute its judgment of the facts for those of the Tribunal or other quasi-judicial bodies, except if there is evidence of obvious abuse. On the other hand, the American courts tend to take a more activist approach in reviewing the facts presented to administrative tribunals like the US International Trade Commission.

Will there over time be a tendency for binational panels to apply such an activist approach to Canadian cases? Panelists might see such an approach as being fully consistent with Canadian law if not with the usual practice of the Federal Court.

The third area which will be interesting to watch will be how the binational panels manage to review the treatment of US or Canadian goods separately from those of other countries in antidumping and countervailing duties cases. Difficulties may arise because of the practice of both countries of "cumulating" the injury from dumped or subsidized imports from a number of sources (under the practice of cumulation, the Tribunal need not consider in a multicountry case whether the dumped or subsidized imports from any one country by themselves are sufficient to cause material injury).

How can the binational panels consider the appropriateness of decisions on US or Canadian goods without taking into account their treatment relative to goods from third countries? If an appeal is made at the same time to one or other of the parties' domestic courts relating to the treatment of goods from third countries, how can the courts review this treatment without also considering that of US or Canadian goods in the same case? In such cases, would the binational panels and the courts in practice apply the same standards of review? In the event of different decisions on the same case, which view would prevail, that of the courts or of the binational panels?

Lawyers do not like to ask hypothetical questions. One can hope that practice under the Agreement shows these questions to be the product of an overactive imagination.

FTA Safeguard Petitions

Finally, under the heading of FTA matters affecting the Tribunal is the question of import safeguard actions between the two countries. I will make only a couple of observations on this point. One relates to the requirement that each country's goods be excluded from Article XIX safeguard actions if they are not considered "substantial." The Agreement states that "not substantial" would normally mean less than a range of 5 to 10 per cent of imports. The facts found by the Tribunal in its injury inquiry and its judgment in each particular case of what is substantial should be helpful to the government in deciding whether or not to exclude US goods from a safeguard action and in defending that decision.

The second observation relates to the provision in the Agreement for a bilateral safeguard track to apply during the ten-year transition period. It allows a onetime suspension for any product for a period of up to three years of FTA scheduled tariff reductions, or even a return to MFN rates. Here again, safeguard action can only be taken as a result of an injury finding by the CITT.

The CITT's Current Activities and Future Directions

The CITT is well launched. Six of nine members have been appointed. Virtually all the senior staff positions have been filled with well qualified people. Nonetheless, the CITT is still at the stage of institution building and will be for many months. As it builds, it will be dealing this year with a heavy work load of customs and excise tax appeals, antidumping and countervailing duties work, including up to 20 reviews of earlier findings, and the textile tariffs inquiry.

There are a couple of "institution building" projects which I might mention in conclusion. The first is the development of new rules of procedure to govern the work of the Tribunal. The CITT has inherited from the Canadian Import Tribunal a set of highly developed and much admired rules related to the Special Import Measures Act. From the Tariff Board and the Textile and Clothing Board, the Tribunal has inherited informal but well-established and proven practices, none of them in the form of written rules.

The challenge is to produce written rules for all aspects of the Tribunal's work which respect the various traditions it has inherited. The rules must find the right balance between accessibility, informality and expeditiousness on one side, and on the other, predictability, transparency and fairness.

Our efforts to draft new rules of procedure have been underway for several months and have benefited from consultations with the trade bar and trade consultants. We expect to make our new rules known by midyear. In the meantime, the approach we have decided on for the textile tariffs inquiry gives an indication of the direction of our thinking.

For the first time in any general trade or tariff inquiry, cross-examination of witnesses will be permitted as a means of testing the evidence presented. The Tribunal will work with interested parties, including through pre-hearing conferences, however, to ensure that cross-examination is pertinent and does not take too much time. At the same time, the Tribunal has clearly indicated the strong protection it will give to confidential information through the handling of documents, enforcement of undertakings by counsel, and use of *in* *camera* sessions to ensure that parties have the confidence to fully bring forward their evidence.

The second building project, and one I particularly cherish, is the development of the Tribunal's capacity to undertake general economic and trade inquiries. This was, as I said earlier, one of the prime motivations behind the amalgamation project. The government's purpose was to provide a vehicle through which Canadian trade policy could be opened up, and not simply through the provision of the direct access facility for safeguard inquiries. I see the government's prompt referral of the textile tariffs inquiry to the Tribunal as an earnest of its intention to follow through on this initiative.

The general inquiry power (section 18) is very broad, referring as it does to "...any matter in relation to the economic, trade or commercial interests of Canada with respect to any goods or services or any class thereof ...." One can imagine a wealth of subjects which the Tribunal's independent research and facilities for public hearings could elucidate for both the public and the government.

General inquiries might involve, for example, publishing the annual trade protection balance sheets which the Economic Council of Canada has suggested we produce, following the example of the Australian Industries Assistance Commission. They could involve trade sectoral adjustment issues such as, for example, the problems of the food processing industry recently referred to by the de Grandpré Council. They might involve an examination of trade negotiations objectives and positions, for example, in the field of tariffs, or subsidies and dumping. The Tribunal cannot set its own work program in this area. However, it must and will be in a position to respond when the government refers to it general trade and economic questions.

The Tribunal is not lacking either in work or in ambition. But what do its building projects have to do with trade liberalization? In my view, they have everything to do with it, whether it is of the bilateral or multilateral sort.

The Tribunal offers procedures and facilities for independent research and public discussion of trade-related problems by all interested parties. These are vital tools in the struggle to make the Canadian economy more competitive, to ensure that access to the Canadian market is given under appropriate conditions, and to open foreign markets to our goods and services. The Canadian International Trade Tribunal is a happy warrior in this battle.

Annex I

The CITT: What It Is and What It Does

The CITT is an independent, quasi-judicial body which reports to Parliament through the Minister of Finance. It is organized as a government department separate from the Department of Finance.

The main legislation governing the work of the CITT is the Canadian International Trade Tribunal Act and its regulations, the Special Import Measures Act, the Customs Act, the Excise Tax Act and the Canada-US Free Trade Agreement Act.

The Tribunal carries out its statutory responsibilities in an independent and impartial manner. While the government or the minister may request the Tribunal to conduct various inquiries, such requests are made publicly and the Tribunal decides the manner in which it will respond.

The Tribunal is composed of nine full-time members including a Chairman and two Vice-Chairmen, all of whom serve terms of up to five years. Members come from a variety of backgrounds, careers and regions.

The Tribunal is supported by a staff of just over 80. Its principal officers are the Executive Director, Research, responsible for economic and financial analysis of firms, industries and other parties involved in Tribunal inquiries; the Secretary, responsible for administration, relations with the public, government departments, and other governments, and the court registrar functions of the Tribunal; and the General Counsel, responsible for the provision of legal services to the Tribunal. About half of the staff work in Research, and the remainder in the Secretary's Department and in Legal Services.

The CITT, as a quasi-judicial body, has rules and procedures similar to those of a court of law, but not quite as formal or strict. The CITT Act states that hearings, conducted by panels of three members or more, should be carried out as "informally and expeditiously" as possible. The CITT has the power to subpoena witnesses and require parties to submit documents, even when these are commercially confidential. The CITT Act contains provisions that strictly control access to confidential documents.

In virtually all of its programs, the CITT conducts hearings open to the public. These are normally held in Ottawa, Ontario but, when appropriate, may take place anywhere in Canada.

The Tribunal is located in Ottawa and occupies the offices and hearing rooms previously used by the Tariff Board and the Canadian Import Tribunal.

The Tribunal is the main judicial institution in Canada's trade remedies system. On the administrative side, important components include Revenue Canada, Customs and Excise and the Special Trade Relations Bureau of External Affairs. Decisions of the Tribunal can be appealed to the Federal Court of Canada, to GATT dispute settlement panels and, where antidumping and countervailing duty cases involve American trade, to binational panels which are provided for under the Canada-US Free Trade Agreement.

The CITT has both judicial and advisory functions, and a number of its programs fall into each category.

Judicial Functions

For two of its programs, the Tribunal acts as an administrative court. These are:

Appeals from Customs and Excise Decisions: In this program, formerly conducted by the Tariff Board, the CITT offers recourse to those who wish to contest Revenue Canada decisions on customs, excise and related matters. Appeal procedures are informal and accessible to individuals and small businesses.

Dumping and Subsidizing Injury Inquiries: In this program, inherited from the Canadian Import Tribunal, the CITT conducts inquiries and makes findings on whether or not imported goods, which Revenue Canada has found to be dumped or subsidized, are causing "material injury" to Canadian production of such goods. If the Tribunal finds injury, Revenue Canada levies on the imported goods antidumping or countervailing duties equal to the margin of dumping or the subsidy.

Advisory Functions

In a number of its programs, the CITT acts almost as a standing commission of inquiry with powers to conduct research, find facts, hold public hearings and report on a broad range of trade-related matters. These programs relate to various import safeguard inquiries and general inquiries into trade and tariff matters. They are:

Import Safeguard Complaints by Domestic Producers: This program, sometimes called "direct access," is new. Previously, direct access was only available through the Textile and Clothing Board, and limited to the textile and clothing industries.

Under this program, Canadian producers, if they form a "major proportion" of an industry and furnish the Tribunal with a "properly documented complaint," have the right to have the CITT conduct an inquiry into whether imports of goods, like or directly competitive with those which they produce, are being imported in such quantities as to cause or threaten serious injury to Canadian production.

The Tribunal must conduct an inquiry and report its finding to the government. The government must then decide whether to provide relief to the Canadian industry if the Tribunal has found injury. The government has the option also, if the Tribunal has undertaken a producer-directed inquiry, to ask it to make recommendations on appropriate safeguard action or adjustment assistance, if the Tribunal finds injury.

Import Safeguard Complaints Concerning the GPT or CARIBCAN: As part of its policy to promote economic development in developing countries, the government applies under its General Preferential Tariff (GPT) Program a reduced import tariff to the products of more than 150 countries. Under CARIBCAN, the government provides duty-free access for most products exported to Canada by the Commonwealth Caribbean countries.

Producers who believe they are being injured or threatened with injury by imports receiving GPT or CARIBCAN preferences may ask the CITT to conduct a safeguard inquiry. If, on the basis of the producer's properly documented complaint, the CITT feels there is *prima facie* evidence of injury, it must conduct an inquiry and report on whether there is injury to Canadian production as a result of the GPT or CARIBCAN. If the Tribunal finds injury, it is up to the government to decide whether or not to remove or modify the GPT or CARIBCAN preference. This program was formerly carried out by the Tariff Board.

Import Safeguard Inquiries Referred by Government: If the government considers that imports of a particular product are causing or threatening to cause "serious injury" to Canadian producers of that product, it may ask the Tribunal to conduct an inquiry into, and report on, whether injury has occurred or is likely to occur. The government may also ask the Tribunal to make recommendations if it finds serious injury on how that injury might be alleviated, for example, by import quotas or surcharges or by adjustment assistance measures. The decision on whether to provide relief rests with the government. In the past, both the Canadian Import Tribunal and the Textile and Clothing Board could be asked by the government to conduct such inquiries.

General Inquiries into Economic, Trade and Tariff Matters

The government may ask the CITT to conduct an inquiry and to report on any matter relating to the economic, trade or commercial interests of Canada. The Minister of Finance also may ask the Tribunal to conduct an inquiry and report on any tariff-related matter including any such matter which concerns the international rights and obligations of Canada.

The three predecessor bodies could undertake general trade and tariff inquiries at the request of the government. The CITT's powers are broader, covering not simply import trade, but any matter relating to trade which affects Canada's economic and commercial situation and negotiating interests.

When the CITT conducts a general inquiry of this sort, it will normally invite written submissions from interested parties, publish its own background papers and hold public hearings as a means of getting into the open all the facts and opinions which are relevant to the inquiry.

IV.

Unfinished Business

The Future on the Table: The Continuing Negotiating Agenda under the Canada-United States Free Trade Agreement.

Michael M. Hart

On January 2, 1988, US President Ronald Reagan and Canadian Prime Minister Brian Mulroney signed the Canada-United States Free Trade Agreement (FTA), bringing to a successful conclusion over two years of preparations and almost two years of negotiations. Following the passage of implementing legislation by the two governments and an exchange of instruments of ratification, the Agreement went into effect on January 1, 1989.[1]

The FTA is the most comprehensive and far-reaching trade agreement ever signed between two sovereign nations. It establishes a coherent and binding framework of rules tailored to the trade and investment realities of the 1990s by:

- completing the process of trade liberalization begun between Canada and the United States with the bilateral agreements of 1935 and 1938

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[1] The Canada-US Free trade Agreement is freely available from the Department of External Affairs. Canadian implementing legislation, Bill C-2, an *Act to Implement the Free Trade Agreement between Canada and the United States*, received royal assent on December 28, 1988. The text of the Agreement, including its tariff annexes, are appended to the Act. US implementing legislation, the *United States-Canada Free Trade Agreement Implementation Act of 1988* (Public Law 100-449) was signed by the president on September 22, 1988.

and continued through the GATT, the Autopact and the defence production sharing arrangements[2]
- continuing the process of bilateral rule-making begun in 1935
- establishing for the first time a bilateral, contractual institutional basis for the management of the bilateral trade and economic relationship[3]
- introducing the rule of nondiscrimination to the new frontiers of trade policy such as trade in services and investment
- setting important precedents for global rule-making
- launching the bilateral negotiating agenda of the future.

As such, it should diminish the role of politics in bilateral trade relations, strengthen the rule of law and provide for a more constructive atmosphere within which Canadian and American traders and investors can plan and grow in the future. The Agreement should also prove a dynamic instrument for managing change in the North American context and for making the trade and investment climate in the two countries even more open and secure. By succeeding in that challenge, Canada and the United States will be able to continue to show the rest of the world that managing change positively and constructively is the best way forward.

Why Canada Sought an Agreement

Canada is a trading nation. One third of its wealth is derived from trade. More than half of the goods produced are exported; more than half of the goods consumed are imported. In order to survive, Canada needs open and secure access to world markets.

For years, Canadians have exported a relatively narrow range of commodities, first to Britain and then to the United States. A broader spectrum of imports came initially from a wider range of sources but have increasingly originated in the United States. Almost two thirds of Canadian exports continue to be based on resources and many are sold at low stages of processing. But there are now many more competitors offering resource products. The export of resources thus offers an increasingly insecure basis to induce Canadian economic development. Outside of the auto industry, which has benefited from the integrating forces of the Autopact, only a small amount of finished goods have traditionally been exported. Canadian manufacturers have tended to concentrate on the domestic market, competing with imports behind the shelter of the tariff and other protective devices. But an increasing number of manufacturers want to compete on world markets and see their future in the development of a more competitive, outward-oriented economy relying on more than the resource industries. That is hard to do on the basis of a domestic market of only 25 million. It requires open and secure access to a large market – preferably the world market.

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[2] The 1935 and 1938 agreements are available as No. 9 (1936) and No. 8 (1939) respectively in the Canada Treaty Series. The original General Agreement on Tariffs and Trade (GATT) and related documents suspending the 1938 Canada-US agreement can be found as No. 27 and 27A (1947) in that same series and has been periodically reissued as a result of revisions. The 1965 Autopact is No. 14 (1966). The Defence Production Sharing Arrangements are contained in a series of agreements, letters and understandings dating back to the 1941 Hyde Park Declaration issued by President Roosevelt and Prime Minister King.

[3] None of the previous bilateral agreements contained any institutional provisions and no more than the most rudimentary notification and consultation procedures. In the absence of any satisfactory bilateral arrangements, the GATT has, therefore, from 1948 on, functioned as the institutional basis for the management of the bilateral relationship.

Americans have proven to be Canada's most reliable customer for finished and semifinished goods. The Europeans and Japanese continue to be important sources for finished goods, but they are not major buyers of anything other than Canadian resources. This is more than a matter of geography and business practices, which naturally ease commercial ties with the United States. It is also a matter of attitude and protection. The European and Japanese markets are more inward looking than the American market and thus frustrate enterprising Canadians who want to do business there. Efforts to change this in the 1970s with framework agreements did not lead to any significant breakthroughs.[4]

For forty years, Canada sought to achieve secure and open access to larger markets through GATT negotiations, supplemented, when it suited, by bilateral deals with the Americans, Europeans and Japanese. Progress was made, but not enough. The GATT process has become increasingly slow and complex. It takes a long time to build consensus among 96 countries and that consensus is likely to be the lowest common denominator, only remotely related to the specific objectives of any one country. For Canada and the

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[4] In the 1970s, as part of its "third option" policy, Canada sought to diversify its trading patterns by negotiating framework agreements with both the EC and Japan providing for periodic consultations to resolve bilateral problems. In the absence of contractual access commitments, however, these agreements have done little either to resolve problems or to boost business confidence in the long-term viability of these markets. For a more detailed description of Canadian concerns with the European and Japanese markets, see Michael Hart, *Canadian Economic Development and the International Trading System* (Toronto: University of Toronto Press, 1985).

United States, the GATT has become a more and more frustrating place to settle bilateral issues.[5]

The GATT is in urgent need of reform. Not only are the rules that deal with trade in goods beginning to show their age, but there are virtually no rules to deal with trade in services, with trade-related investment measures and with intellectual property protection. In short, the GATT rules dealing with the industries of the past are proving inadequate and rules for the industries of the future are nonexistent. The rules dealing with trade in agriculture have always been inadequate.[6]

Over the past three years, progress has been made in bringing the GATT up to date, but not nearly enough. While Canada and the United States began and concluded their bilateral negotiations, the GATT countries were also at work, but at a snail's pace. GATT ministers met in Montreal in December 1988 to review progress on the negotiating agenda they approved in September 1986. They left somewhat disappointed. It was not possible to reach consensus on the approach to be taken to all 15 major negotiating issues. While efforts to bridge the differences continued and were resolved at a meeting of senior officials in Geneva the following April and negotiations on all issues are now fully engaged, the Montreal meeting underlined the difficulties of reaching consensus among the more than 100 participating countries on the complex agenda of modern trade negotiations. Hardening resistance to adjustment and the wide disparity in economic development and attitudes among the participating countries suggest that when consensus is finally reached, it will be considerably less ambitious than the objectives set for the negotiations by either Canada or the United States or than what was achieved in the bilateral agreement.[7]

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[5] For a detailed discussion of the GATT and Canadian participation and interests, see W. Frank Stone, *Canada, the GATT and the International Trade System* (Montreal: Institute for Research on Public Policy, 1984). A new edition with two additional chapters on developments in the 1980s and the implications of the new Canada-US Agreement for GATT is forthcoming. More generally, on the relationship between GATT and the FTA, see Frank Stone, "Relationship to GATT," in John Crispo, ed., *Free Trade: the real story* (Toronto: Gage, 1988); D. L. McLachlan, A. Apuzzo and W. A. Kerr, "The Canada-U.S. Free Trade Agreement: A Canadian Perspective," *Journal of World Trade*, vol. 22, no. 4 (1988), pp. 9-34; and Michael Hart, "GATT Article XXIV and the Canada-United States Trade Negotiations," in *Review of International Business Law*, Vol. 1, No. 3 (September, 1987), pp. 317-355. William Diebold in *Bilateralism, Multilateralism and Canada in US Trade Policy* (New York: Council on Foreign Relations, 1988) takes the issue further and looks at the long-term implication of the move by Canada and the United States to solve their problems bilaterally. The FTA, he suggests, has significant implications for the multilateral trading system and for future US and Canadian trade policy, implications which have yet to be seriously thought through.

[6] Numerous commentators have outlined some of the problems experienced in the GATT and the GATT-based trade relations system. For Canadian readers, two articles by Rodney Grey are particularly pertinent: "The General Agreement After the Tokyo Round" in John Quinn and Philip Slayton, eds, *Non-Tariff Barriers After the Tokyo Round* (Montreal: Institute for Research on Public Policy, 1982) and "The Decay of the Trade Relations System" in R. H. Snape, ed., *Issues in World Trade Policy: GATT at the Crossroads* (New York: St. Martin's Press, 1986). More generally, see Miriam Camps and William Diebold Jr., *The New Multilateralism: Can the World Trading System be Saved* (New York: Council on Foreign Relations, 1983 and 1986) and C. Michael Aho and Jonathan David Aronson, *Trade Talks: America Better Listen* (New York: Council on Foreign Relations, 1985).

Canada and the United States are major players at the GATT. Canada hosted the 1988 mid-term review. Canadian participants have made many suggestions for reform and improvement. Canada's GATT ambassador chairs the important negotiating group examining the need to rewrite some of the GATT articles. The United States has set the pace on many of the issues now being considered at the Uruguay Round. But both Canadians and Americans have become increasingly conscious of GATT's limitations. If it ever was, it certainly is no longer a sufficient instrument for managing the largest bilateral trade and economic relationship in the world. This is why the two countries entered into the Autopact, into the defence production sharing arrangement, a safeguard agreement and many more bilateral deals. And this is why they entered into negotiations for a comprehensive agreement in 1985.

There was an even more urgent reason. Canadians had become increasingly reliant on the American market as the main outlet for their exports. But that market was turning inward. Americans were frustrated by their lack of access to the markets of Japan, Europe, Korea, Brazil and elsewhere and by the increasing flow of imports from these countries. Their frustration was turning into anger and Canadians found themselves sideswiped by this anger. Canadians also found themselves the targets of protectionist fervour. Thus Canadian entrepreneurs, ready to break out of the constraints of the

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[7] A detailed survey of the issues in the Uruguay Round and thus of the agenda for reform, told largely from the point of view of the interests of developing countries, can be found in J. Michael Finger and Andrzej Olechowski, *The Uruguay Round: A Handbook on the Multilateral Trade Negotiations* (Washington: World Bank, 1988). Also of interest are two US background publications: Congressional Budget Office, *The GATT Negotiations and US Trade Policy* (Washington, 1987) and John M. Leddy, ed., *The Uruguay Round of Multilateral Trade Negotiations Under GATT: Policy Proposals on Trade and Services* (Washington: The Atlantic Council, 1987). The fourth in a series of booklets sponsored by the British North America Committee also deals with the Uruguay Round: Sidney Golt, *The GATT Negotiations 1986-1990* (Toronto: C.D. Howe Institute, 1988).

Canadian market, found the one foreign market that traditionally welcomed their goods not so sure any more.[8]

In 1983, the Liberal government of Pierre Trudeau decided, after the failure of the GATT ministerial meeting of the previous year, to see if a range of outstanding issues between Canada and the United States could not be resolved by negotiating sectoral free trade agreements.[9] Both governments attacked the problem with enthusiasm, but at the end of a year concluded that, while the objective was sound, the means were inadequate. It was too difficult to find a match of sectors where both countries saw advantages. Only in a broadly based negotiation is it possible to make cross-sectoral trade-offs. And they concluded that what they were doing could not be squared with their GATT obligations. The initiative was dead in the water by the summer of 1984. The issue was whether to give up or expand the talks into a broader initiative.

That was the issue that faced Canadians in September 1984. A year later, after the most extensive consultations ever undertaken, armed with drawers full of studies and with the benefit of a strong recommendation from the most expensive Royal Commission[10] ever established, the government decided to proceed. The overture was warmly welcomed by the US government and negotiations began less than a year later.

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[8] While it is true that the United States has lowered its tariff to the point where its average incidence is less than 5 per cent, and has additionally removed other traditional customs barriers, in their place have emerged other forms of protection such as enhanced trade remedy laws (such as antidumping and countervailing duties), product specific restrictions (many not GATT-legal) and Buy America restrictions. The combined effect of these measures has made access to the US market uncertain. For an early analysis of the growing problem for Canada of the new American protectionism, see Rodney de C. Grey, *United States Trade Policy Legislation: A Canadian View* (Montreal: The Institute for Research on Public Policy, 1982). Grey's views have been challenged by some American authors and thus generated a lively literature; many would now agree, however, that the trend in US trade policy in the 1980s has been protectionist. See also, Harold Hongju Koh, "A Legal Perspective" in Robert M. Stern, Philip H. Trezise and John Whalley, eds, *Perspectives on a US Canadian Free Trade Agreement* (Washington: Brookings Institution, 1987) as well as the comments by Michael Hart. For a broad discussion, see William R. Cline, ed., *Trade Policy in the 1980s* (Washington: Institute for International Economics, 1983).

[9] See Michael Hart, *Some Thoughts on Canada-United States Sectoral Free Trade* (Montreal: Institute for Research on Public Policy, 1985).

[10] These recommendations and the supporting arguments are contained in volume one of the *Final Report* of the Royal Commission on the Economic Union and Development Prospects for Canada (Ottawa: Supply and Services, 1985), popularly known as the Macdonald Commission. At least 12 of the volumes of research prepared for the Commission (published separately by the University of Toronto Press, 1985) are also devoted to the bilateral trade issue.

What Was Negotiated

It took two years to change dreams into reality. There was much frustration along the way and also some drama, but the negotiations were crowned with success almost two years to the day that the prime minister and president exchanged letters committing their governments to a broadly based trade negotiation.[11] Canada sought three overriding objectives:

- The most important, if least publicized, was to effect domestic economic reform by eliminating, at least for trade with the United States, the last vestiges of standing forms of protection in both countries, such as the tariff, and constrain the more subtle new instruments of protection. By exposing the economy to greater international competition, Canadian firms would need to restructure and modernize and become more efficient and productive.
- The most publicized was to provide a bulwark against US protectionism. By gaining more secure and open access to the large, contiguous US market, Canadian business would be able to plan and grow with greater confidence and gain an incentive to accept the challenge of increased competition from the United States.
- Finally, the agreement was meant to provide an improved and more modern basis for managing the Canada-US relationship. Since 1948, the GATT had served this function but had increasingly proved inadequate. New and more enforceable rules combined with more sophisticated institutional machinery would put the relationship on a more predictable and less confrontational footing.

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[11] The author has prepared a detailed account of the negotiations which is currently being reviewed by the federal government in Canada before being released for publication. Until this account is published, the most detailed available account other than that of the press is by Gordon Ritchie in John Crispo, ed., *Free Trade: the real story* (Toronto: Gage, 1988) and in an introduction to Jon R. Johnson and Joel S. Schachter, *The Free Trade Agreement: A Comprehensive Guide* (Toronto: Canada Law Book, 1988). As well, Ambassador Ritchie's detailed testimony before the Senate Foreign Affairs Committee in the fall of 1987 and spring of 1988 adds further detail. Simon Reisman's perspective on the negotiating process is provided in greatest detail in an interview with Deborah McGregor in the *Financial Times of Canada*, July 25, 1989. An American perspective can be found in Peter McPherson, "Political Perspectives" in Jeffrey J. Schott and Murray G. Smith, eds, *The Canada-United States Free Trade Agreement: The Global Impact* (Ottawa and Washington: Institute for Research on Public Policy and Institute for International Economics, 1988).

The FTA meets these three fundamental objectives and more.[12] The preamble and first chapter set out the basic aims and objectives of the two governments and provide the philosophical framework within which the whole Agreement must be viewed. In future, should there be a dispute, it is to these words that dispute settlement panels will turn in order to determine the object and purpose of the Agreement. It is here, for example, that the two governments agree to promote productivity, full employment and a steady improvement in living standards while preserving their flexibility to safeguard the public welfare.

The heart of the Agreement can be found in Part Two containing chapters 3 to 13. These establish a good but conventional free trade agreement. They provide a sensible set of rules fully consistent with GATT Article XXIV. Many of the clauses in these chapters are drawn directly out of the GATT or provide agreed interpretations of GATT provisions.[13] There is nothing startling in these chapters. They take a set of good rules and make them better. Where either side was not prepared to go as far as the other, provisions were made to continue negotiations, but within a new and more secure framework. These chapters also eliminate most remaining barriers to trade, especially the tariff, and thus give Canadians more open access to that large market of 270 million people they have long sought.[14]

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[12] The FTA and the debate preceding and during the negotiations has generated a lively and growing literature. Among commentaries on the Agreement and its implications, see Murray G. Smith and Frank Stone, eds, *Assessing the Canada-U.S. Free Trade Agreement* (Halifax: The Institute for Research on Public Policy, 1987); Jeffrey J. Schott and Murray G. Smith, eds, *The Canada-United States Free Trade Agreement: The Global Impact* (Ottawa and Washington: Institute for Research on Public Policy and Institute for International Economics, 1988); William Diebold, Jr., ed., *Bilateralism, Multilateralism and Canada in US Trade Policy* (New York: Council on Foreign Relations, 1988); Richard G. Lipsey and Robert C. York, *Evaluating the Free Trade Deal: A Guided Tour through the Canada-U.S. Agreement* (Toronto: C. D. Howe Institute, 1988); and Donald M. McRae and Debra P. Steger, eds, *Understanding the Free Trade Agreement* (Halifax: Institute for Research on Public Policy, 1988).

[13] For example: Article 104 provides a general affirmation of GATT rights and obligations, as well as any other pre-existing rights and obligations under other agreements, such as the Autopact; Articles 407 and 409 and 902 and 904 clarify existing GATT rights and obligations under GATT Articles I, II, XI, XIII and XX with respect to import and export restrictions and prohibitions; Article 501 incorporates Article III of the GATT respecting national treatment rights and obligations; Article 602 affirms rights and obligations under the GATT *Agreement on Technical Barriers;* Article 710 affirms GATT rights with respect to supply management measures; Article 1201 incorporates the exceptions clauses of GATT Article XX; Chapter 13 builds on the GATT *Agreement on Government Procurement;* Article 1801 affirms the right of the two parties to solve disputes arising under either the GATT or the FTA in either forum, for example in regard to FTA Article 501/GATT Article III; Article 2010 is a modernized version of GATT Article XVII regarding state-trading practices; and Article 2011 incorporates parts of GATT Article XXIII.

Part Two of the Agreement also includes four sectoral chapters setting out in some detail special provisions relating to trade in agricultural products (Chapter 7), trade in wine and spirits (Chapter 8), energy trade (Chapter 9) and trade in automotive products (Chapter 10). In each of these instances, the general provisions of Chapters 3 through 6 and 11 and 12 were considered either too rigorous for the products covered or insufficient to deal with special problems. The extent to which these chapters exempt products from the general provisions is generally less than in similar sectoral exemptions in other free trade agreements. For example, unlike European free trade agreements, the tariff is eliminated on all agricultural products.

Chapters 14 to 17 make a cautious start on the so-called new issues of services, business travel, investment and financial services. They recognize that international commerce is more than a matter of shipping goods to one another. In these four chapters, the two governments decided to freeze the *status quo* and promised that any future laws and regulations will be based on the premise of nondiscrimination. Canada and the United States will treat each other's service providers and investors as well as business travellers as they treat their own. The two countries made a similar commitment with regard to trade in goods in 1935 and then gradually rolled back and eliminated areas where they did discriminate, a job they finally finished in 1987. They have agreed that they will try to do the same for the service industries and investors under the FTA.[15]

The 1935 agreement was an important precedent for the world and formed the basis for later multilateral negotiations. The 1987 FTA does the same for the new issues. It is again trailblazing. Canada and the United States are again showing the way to the future. The Australians and New Zealanders have been the first to accept this lead. They have now updated their bilateral agreement along similar lines. The 96 members of the GATT are trying to do the same in the Uruguay Round. The Europeans are looking forward to consolidating their common market by dealing with these issues as they move forward to a more integrated market by 1992. The rest of the world is not standing still – other nations are also solving problems on a regional basis.

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[14] Alec Macpherson, an experienced Canadian trade official, makes essentially the same point in "The Canada-U.S. Free Trade Agreement: Tariffs and Customs Procedures" in Donald M. McRae and Debra P. Steger, eds, *Understanding the Free Trade Agreement* (Halifax: Institute for Research on Public Policy, 1988). Nevertheless, Canadian critics of the Agreement continue to insist that many of these conventional obligations have exposed Canada to new dangers of US domination.

[15] The issue of discrimination and the challenge of the application of the principle of national treatment to the new issues is discussed in more detail in Michael Hart, "The Mercantilist's Lament: National Treatment and Modern Trade Negotiations" *Journal of World Trade Law*, Vol. 21, no. 6 (December, 1987), pp. 37-61.

Thirdly, chapters 18 and 19 achieve a Canadian quest of long standing: a contractual institutional basis for managing the trade and economic relationship. Chapter 18 takes well-established GATT practice, commits it to a clear body of rules and procedures, and applies these to the rights and obligations of the Agreement as a whole -- to the enhanced and improved GATT-like rules dealing with trade in goods as well as the rules dealing with services, investment and business travel. For the first time, there exists a clear mechanism which puts Canada and the United States on an equal, one-on-one footing. The Agreement as a whole provides the rules – Chapter 18 provides a neutral referee to enforce those rules.

Chapter 19 deals with the thorny issue of trade remedies. Here the United States recognizes for the first time that disputes between the two countries are not a matter for the application of domestic law and unilateral decisions alone, but should be subject to bilateral dispute settlement. They provide an important beginning. While both countries will continue to rely on their respective trade remedy laws, they have agreed to replace judicial review of domestic decisions with bilateral review. Canadians will sit on panels to determine whether US law was properly followed and *vice versa*. And Canadians will sit on panels that will determine whether any changes in US law are consistent with GATT, the GATT Codes and the FTA. Together these provisions provide an important shield against abuse and harassment. It is less than Canada sought, but it is a lot more than it had.

An End and a Beginning

As comprehensive and detailed as the Agreement is, it is incomplete. At the end of 18 months of intense negotiations, the two sides had to admit that there were some issues that required more work, that could not be resolved within the available time frame, or that required the mutual confidence and knowledge that would flow from experience under the Agreement. For many of these issues, the FTA sets out procedures for continued negotiations. The FTA, therefore, establishes an agenda for future negotiations and represents a new beginning to the evolutionary process of managing bilateral relations. It recognizes that some negotiations will of necessity take place in the multilateral forum of the GATT because of the broad nature of the issues, while others will continue on a bilateral basis addressing problems that are unique or acute in the Canada-US context. It thus establishes a two-track approach to trade policy.

In the available space, it is not possible to analyze in detail all the areas where the FTA provides a dynamic basis for managing change in the North American economy. The importance and difficulty of the issues vary. Some of the continuing negotiations will involve largely technical discussions leading to changes in annexes or in administration. Others will require wholesale negotiation and involve very profound differences between the two countries. The following pages suggest the wide range and scope of these ongoing discussions and the direction discussions are likely to take.

Improvements in Customs Administration

Tariff Acceleration

The FTA provides for three stages of tariff elimination: immediate; in 5 equal stages over 5 years; and in 10 equal stages over 10 years. The Agreement, however, provides for either Party to seek accelerated elimination (Article 401:5). Based on the experience of the past and in other agreements, there will be producers and users who will suggest that they want to see the tariff eliminated more quickly. To date, both governments have already received representations to that effect and preliminary discussions suggest that many can be accommodated without great difficulty. On March 13, 1989, at the first formal meeting of the Canada-United States Trade Commission, the two governments quickly agreed on the desirability of negotiating accelerated tariff reductions. Any such changes will likely result from technical level discussions in the first few years and be introduced without much fanfare.

Rules of origin

FTA Chapter 3 establishes the rules of origin for the Agreement. In effect, it establishes hundreds if not thousands of product-specific rules of origin. While Article 301 sets out the general rule and Article 304 the all-important definitions, the real rules are contained in Annex 301.2 which sets out how the general rules will be applied on a product-specific basis. This approach has some important implications for the future. It means that individual producers will need to know precisely how the rules apply to the products that they wish to trade on a duty-free basis and it means that the rules can be readily adjusted to meet specific and changing circumstances. The advantage of what appears at first to be a highly complex system is that, once the basic rule and its application is understood by individual manufacturers, it becomes a predictable and unchanging rule. It will not, for example, be subjected to the vagaries of changing interpretation as has been the case for the more widely applied US substantial transformation rule. In effect, the FTA specifies what substantial transformation means in every instance and limits the application of a 50 per cent value added rule to the situations where it makes economic sense.[16]

Again, changes in these rules will not be the subject of major negotiations but of technical adjustments. In drafting the provisions of Chapter 3, both governments pursued extensive consultations with industry but obviously could not meet with all manufacturers. The provisions of Article 303 anticipate that there will be changes. To date, producers on both sides of the border have already identified areas where adjustments would be desirable and preliminary discussions to this end have already started.[17]

The rules of origin are based on the new Harmonized System (HS) of tariff classification. The HS is based on the long established and widely used Brussels Tariff Nomenclature and its successor, the Customs Cooperation Council Tariff Nomenclature, but its concepts are new to Canada and the United States. Canada introduced the HS in 1988 and the United States in 1989. Inevitably, therefore, the two customs administrations will experience some growing pains in applying the new system and these will influence their experience with the application of the rules of origin. It is to be expected, therefore, that for the first few years there will also need to be some adjustments in the provisions of Chapter 3 resulting from experience with the HS.[18]

The ability of both governments to satisfy producer requests for accelerated tariff elimination and adjustments in the rules of origin will provide early indications of the ability of the two governments to ensure that the Agreement becomes a dynamic instrument for managing change.

Standards and Phytosanitary Regulations

Technical regulations for health, safety, sanitary and consumer protectio reasons can constitute severe barriers to trade if they are applied in discriminatory or arbitrary manner, but the right to maintain regulations t protect human, animal and plant life, the environment or for a variety o other purposes is a sovereign issue for each country to decide. The ability to make such decisions is fully protected in both the GATT and the FTA. The challenge is to ensure that such rules are not abused and become disguised protectionist trade measures. [19]

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[16] See Alec Macpherson, "The Canada-U.S. Free Trade Agreement: Tariffs and Customs Procedures" in Donald M. McRae and Debra P. Steger, eds, *Understanding the Free Trade Agreement* (Halifax: Institute for Research on Public Policy, 1988).

[17] At the first meeting of the Canada-US Trade Commission on March 13, 1989.

[18] During the first six months of 1989, the US Customs Service issued literally thousands of customs classification rulings as users and administrators learned to use the HS.

In the FTA, Canada and the United States affirm their obligations under the GATT Agreement on Technical Barriers to Trade to avoid the use of standards-related measures as unnecessary obstacles to trade. The Agreement establishes the general principle of national treatment. It requires that the two governments treat goods originating in the other country identical to goods of domestic origin once they have satisfied all customs formalities, including any standards. The two governments will also endeavour to make their respective standards-related measures and procedures more compatible and thus reduce the obstacles to trade and the costs of exporting which arise from having to meet different standards. Since many standards-related measures are developed by private organizations in both Canada and the United States (such as the Canadian Standards Association or the Underwriters Laboratory), and they have already made much progress developing compatible standards, all that the two governments can do is encourage these organizations to continue to work toward greater compatibility.

Achieving full or higher degrees of compatibility or harmonization is a technically daunting task. Should harmonization take place on the basis of the higher or lower standards? Are conditions identical? Does a higher standard serve a useful function or is it a disguised restriction to trade? What the Agreement encourages is a process of further reducing the trade-distorting effects of differing standards and a framework within which such differences can be eliminated on a contractual basis.

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[19] Comments in Canada by critics of the FTA worried about Canada's ability to protect the environment or maintain its own product standards exhibit ignorance of Canada's existing obligations under the GATT and other international agreements as well as the extent of the national treatment obligations in the GATT (Article III) incorporated into the FTA (Chapter 5) and the general exceptions article of the GATT (Article XX) also incorporated into the FTA (Chapter 12). The national treatment obligation requires Canada to treat US goods, once imported and satisfying all customs requirements, the same as Canadian goods. There is no obligation to treat US goods as they are treated in the United States. Thus as long as Canada does not discriminate, it is free to develop whatever standards and other internal regulations considered necessary. Nevertheless, should there be a need to discriminate for environmental reasons, for example, this is allowed by the general exceptions provisions, as long as such discrimination serves a legitimate environmental reason and is not a disguised restriction on trade. It is also not well appreciated in Canada that, in most instances, US environmental protection standards are more stringent than similar requirements in Canada.

In the case of phytosanitary regulations (health and safety regulations relating to agricultural commodities), there is a detailed program for consultation laid out in an annex to Article 708. It establishes a contractual framework within which the respective agricultural authorities will work to eliminate unnecessary differences in their health regulations.

The gradual elimination of differences in industrial standards and testing procedures and in phytosanitary regulations and procedures will encourage more trade and place it on a more secure footing. Progress, however, is likely to be gradual and ongoing, rather than the result of major breakthroughs and is likely to be implemented on a piecemeal basis. Again, progress on these issues will be an indication to entrepreneurs on both sides of the border that the two governments see the Agreement as a dynamic rather than static instrument.

Sectoral Issues

Agriculture Trade Practices

As noted earlier, the FTA, unlike many other such agreements negotiated in Europe and elsewhere, does not exclude trade in agricultural products. It eliminates all agricultural tariffs and a number of specific non-tariff barriers. Nevertheless, some of the most important barriers to trade in agriculture are not addressed. The various price support mechanisms used in Canada and the United States, such as deficiency payments, import quotas and supply management, are not covered. Provision is made, however, for continued negotiations, both multilaterally and bilaterally.

Serious and early progress in tackling these barriers will probably come only if there is a breakthrough at the Uruguay Round of multilateral trade negotiations. The United States and the EC have long been locked in a battle of nerves as to who will disarm first in the expensive game of subsidizing farm production. While Canada also subsidizes agricultural production, albeit for a different mix of products than does the United States, progress will only come when the EC decides to dismantle the main machinery of its Common Agricultural Policy and the United States retreats from the policies enshrined in the Agricultural Adjustment Act of 1933 and subsequent Farm Bills.

Given the struggle between these two titans, progress on the bilateral front is likely to be marginal until such time as there is some movement on the multilateral front. The potential for real commitments multilaterally, however, are greater than they have been for more than a generation. The Agriculture Group in the Uruguay Round is seriously engaged in addressing the trade-distorting domestic practices of member countries with a view to reducing them in the future. A possible contributor to progress may well be the FTA provision requiring the two countries to consult and compare subsidy levels on grains with the aim of liberalizing Canadian import regulations when these levels are agreed to be equal.

The Automotive Industry

The two governments recognize in Article 1004 that they have not dealt with all the problems in automotive trade and they therefore agreed to establish a select panel to examine trade and production of automotive products. A thirty-member panel has now been appointed to assess the state of the automotive industry and to propose public policy measures and private initiatives to improve its competitiveness in domestic and foreign markets. The members, 15 from each country, represent a wide spectrum of interests and backgrounds and are expected to conclude their work by June 30, 1991.[20] It is likely that its report will eventually lead to a need for further discussion and negotiation. It would be premature, however, to speculate on the nature of such discussions and possible negotiations.

Enhancement of Access

While the Agreement provides for the reduction and elimination of the tariff and other barriers to trade and spells out codes of conduct to reduce the restrictive effect of various trade and domestic policies, there remain significant barriers to trade between the two countries and thus efforts to reduce or eliminate these barriers will continue. The most significant remaining barrier is the protection afforded to domestic producers by government procurement preferences.

Government Procurement

For more than a decade, Canada has sought a more open US procurement system. GATT rules exempt purchases by governments for their own use from national treatment requirements. In other words, it allows governments to discriminate in a manner that is not tolerated for private sector transactions. This was originally not considered a major breach of GATT principles. Over the years, however, as government activity grew and, consequently, government purchasing, most governments found that they could use their purchasing as a tool for industrial development or as an instrument for placating special interests or currying political support. Thus, government purchasing is now pursued under two competing objectives: to get value fo money and to achieve social and industrial benefits. In pursuit of the secon rigorous, deeply embedded and far-reaching trade barriers have bee developed to reserve as much as possible for domestic suppliers.

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[20] *The Free Trade Observer*, April 1989, pp. 27-28.

Efforts to introduce GATT principles of nondiscrimination to governme purchasing began in the late 1960s and resulted in the 1979 GATT Procure ment Agreement (the GATT Code) to which both Canada and the Unite States are parties. This opened a limited amount of federal government pu chasing to open international competition. Purchases of goods above threshold (about US$225,000) by specified government departments an agencies (entities) are open to competitive bidding by all signatories of th GATT Code. Generally excluded, however, are those entities that are maj purchasers of capital equipment such as the Departments of Transport an Defence. As well, state and provincial purchasing and purchases below th threshold are not covered. Canada took the view, therefore, that within a fr trade area agreement it should be possible to go much farther and place a government procurement between the partners on a fully competitive basis far as North American suppliers are concerned.

This ambitious objective was not met. All that Chapter 13 of the FTA do is set out better rules to govern purchases open to competitive bilater bidding and to reduce the threshold established in the GATT Code for su bidding. All purchases by entities covered by the Code above US$25,000 a now covered, extending coverage by some 10 to 15 per cent. The obligatio however, remain limited to the two federal governments and no new entiti were added to the coverage.

The result is disappointing, but the two governments did agree that th would continue bilateral negotiations within one year of the conclusion of th current multilateral negotiations with a view to further expanding nondi crimination in government procurement. While it is unlikely that the GAT talks will achieve Canada's objective of the complete elimination of discrim ination in government procurement, it is possible that these will redu discrimination on a broader basis than the FTA, a result of interest to bo countries.

Putting aside the usual political and mercantilist reasons why governme purchasing has proven so impervious to trade liberalization, there are som particular problems in the Canada-US context that will have to be recogniz if there is to be serious progress in the future.

The first is that the forms of discrimination differ. In Canada, both the federal (for contracts not covered by the GATT Code) and provincial governments exclude foreign bidders if there are sufficient domestic suppliers. Additionally, for major purchases, Canada often negotiates industrial or other offsets from foreign suppliers. The United States, on the other hand, welcomes foreign bidders for many contracts but establishes price or content premiums favouring domestic content or suppliers. Additionally, certain contracts are set aside for certain classes of domestic suppliers. In negotiating reductions to these different types of barriers (and in modern mercantilist bargaining, every concession must be "paid for"), it is hard to find matches. Such issues can be more easily resolved in a comprehensive deal, but become exceedingly complicated once a comprehensive deal is sliced into components.

Secondly, there is a large disparity in size between the two economies. The US procurement market is more then 10 times the size of the Canadian market. This is more a perceptual problem than a real problem, since negotiations are about future opportunities: while Canadian producers gain access to a market 10 times as large, they also have to compete in their domestic market with 10 times as many producers. This problem also bedevils other issues, but is particularly acute in government procurement because it is perceived to be a finite market – every gain by a foreign supplier is perceived to be a loss for a domestic supplier. A comprehensive government procurement deal is thus a "hard" political sell in the United States.

Thirdly, since the US economy is much more comprehensive than the Canadian economy, there are few goods that US governments purchase that must be imported, while in the case of Canada, a larger proportion must be purchased from abroad, thus again eroding the perceived benefit to the United States. US producers already have a larger share of the Canadian procurement market than Canadian producers have of the US market.

Finally, since provincial and state governments are major purchasers of internationally traded goods (such as communications and transportation equipment), and also discriminate in their purchasing practices, a truly open government procurement system would require the full cooperation of the state and federal governments. This poses a particularly acute challenge for Canada whose federal government cannot negotiate provincial concessions such as these without provincial consent. Canada's provinces, however, are unlikely to be prepared to cede their authority to discriminate unless they achieve offsetting benefits. Outside of a large agreement, it is hard to envisage such benefits. Some provinces currently discriminate even against out-of-province goods and services and little progress has been made in eliminating these interprovincial barriers; eliminating barriers between Canada and th United States would be an even harder political sell.

Should these various problems be overcome, there are a number of di ferent approaches that the negotiators can take. From a broad trade and ec nomic policy perspective, the best approach is a comprehensive nation treatment deal covering all government purchasing, civil and military, sta and federal. Trade barriers and discrimination undercut efficiency and com petition and in the long run rarely serve their stated purpose. But such comprehensive approach, of course, entails many negotiating problems and might be more realistic to initially limit national treatment, for example, federal civilian purchases and add military (which is to some extent cover by the defence production sharing arrangements) and state and provinci purchases at a later stage. An alternative approach is to continue on the bas of the GATT Code, gradually adding entities to the list of government age cies subject to the Agreement's provisions and gradually eliminating excep tions.

Whatever approach is adopted, the FTA provides an improved framewo for pursuing such negotiations and a commitment that whatever the results multilateral negotiations, there will be continued efforts to extend th coverage of the bilateral agreement.

Continued Rule-Making

While the Agreement provides a comprehensive code of conduct for the tw federal governments in their regulation of trade and investment, it is neither complete code nor expected to be static. The agreement thus anticipat continued negotiations elaborating mutually satisfactory rules. The mo difficult of these involve the commitment in Article 1907 to establish Working Group mandated to develop "more effective rules and disciplin concerning the use of government subsidies" and "a substitute system rules for dealing with unfair pricing and government subsidization," i.e., new bilateral system to replace the current antidumping and antisubsid provisions in US and Canadian trade law. Further rule-making is also a ticipated in the area of services and intellectual property.

Much ink has already been spilled anticipating what will happen durir the subsidy and price discrimination negotiations. Given the experienc during the original negotiations, much ink will continue to be spilled. The issues are extremely difficult and go to the heart of the modern trade relatio system. They deserve, therefore, more extensive treatment than the other parts of the continuing negotiating agenda.[21]

The Subsidy Problem

From the outset of the original bilateral negotiations, subsidies and countervailing duties figured prominently on the negotiating agenda. In their reports to the president and prime minister in September 1985 suggesting that a comprehensive bilateral agreement was both desirable and feasible, United States Trade Representative Clayton Yeutter and International Trade Minister James Kelleher both indicated that this issue was high on their agenda. In fact, with the exception of the tariff, it was the only issue mentioned by both ministers. But their perception of the problem and of possible solutions differed radically. Mr. Yeutter was concerned with controls on Canadian subsidies while Mr. Kelleher worried about US trade remedy law.[22] Thus, one perceived governmental policies and practices to be a key barrier to a more open and secure trading environment and the other worried about the response to those policies and practices.

The question of subsidies is probably the single most important and delicate issue on today's international trade policy agenda. Forty years ago, the architects of the GATT thought it was enough to proscribe what they called export subsidies, direct government assistance contingent on export performance, while permitting other kinds of subsidies; members were free to take measures to offset the distorting effect of other subsidies, i.e, to impose countervailing duties if subsidized imports materially injured domestic production. Subsidization was not a big issue then, but it is a major issue now as the role of government in society has changed substantially. Nevertheless, GATT members have yet to come to an understanding of what constitutes a subsidy and what is material injury. Until these questions are settled, members are free to set their own standards, a right the United States has pursued with increasing zeal through its countervailing duty statute. Such unilateralism, however, runs against the spirit of international agreement and has led and will continue to lead to contentious trade disputes. [23]

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[21] Among the more interesting treatments of this aspect of the Agreement, see the papers and comments by Steger, Coffield, Dearden and Horlick and Valentine in Donald M. McRae and Debra P. Steger, eds, *Understanding the Free Trade Agreement* (Halifax: Institute for Research on Public Policy, 1988) and Gary N. Horlick, Geoffrey D. Oliver and Debra P. Steger "Dispute Resolution Mechanisms" in Jeffrey J. Schott and Murray G. Smith, eds, *The Canada-United States Free Trade Agreement: The Global Impact* (Ottawa and Washington: Institute for Research on Public Policy and Institute for International Economics, 1988). The dissenting views of Canadian economic nationalists, who see the continuing negotiations pursuant to article 1907 as a particular threat to Canadian policy autonomy, can be found in Duncan Cameron, ed., *The Free Trade Deal* (Toronto: James Lorimer, 1988).

[22] The texts of their reports are reproduced in Department of External Affairs, *Canadian Trade Negotiations: Introduction, Selected Documents, Further Reading* (Ottawa: Supply and Services, 1986), pp. 65-72.

In 1986, for example, Canadians were not amused when the US Department of Commerce reversed a 1983 ruling and decided that the fees for cutting logs on crown lands charged by some Canadian provinces were insufficient and thus constituted a countervailable subsidy on exports of lumber to the United States. To Americans, its government was helping out a major industry that was under direct competitive threat from unfairly subsidized exports. To Canadians, the United States was arbitrarily and unilaterally deciding how provincial governments should tax and manage their resource industries. From their point of view, the provinces were free to give trees away. What was a subsidy to Americans was a sovereign right to control resources to Canadians and had nothing to do with trade. Conflicts with such emotional overtones are not easily settled and would benefit from clear rules and procedures that would remove the issue from the political agenda.[24]

A good deal of effort was expended in the bilateral negotiations to come to a common understanding on subsidies. These efforts did not succeed. Canadian negotiators sought a regime that would directly confront the issue of governmental assistance and obviate the need for countervailing duties while American negotiators wanted Canada to stop subsidizing but also wanted to retain the discipline and safety valve of countervailing duties. In the end, these differences could not be bridged in the available time and an imaginative interim solution had to be devised: the two governments would continue to be free to subsidize as well as retain the right to offset any injurious subsidies with countervailing duties (CVD), but the process which determines whether or not a CVD would be applied would be subject to bilateral review. Both governments thus retain their existing domestic procedures but judicial review of these procedures would be assumed by a panel made up of Canadians and Americans rather than by the domestic courts. Meanwhile, it was agreed that the search for a more fundamental solution would continue for the next five to seven years. Failure to effect a solution could formally bring the continued viability of the Agreement into question.

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[23] On the issue of subsidies in international trade from a US perspective see Gary Clyde Hufbauer and Joanna Shelton Erb, *Subsidies in International Trade* (Washington: Institute for International Economics, 1984). Hufbauer provides a handy catalogue of various attitudes to subsidies as an unfair and trade-distorting government practice in "Subsidy Issues After the Tokyo Round" in William R. Cline, ed., *Trade Policy in the 1980s* (Washington: Institute for International Economics, 1983). Kenneth W. Dam, *The GATT: Law and International Economic Organisation* (Chicago: University of Chicago Press, 1970) provides a more balanced treatment. John H. Jackson in "Achieving a Balance in International Trade" *International Business Lawyer*, April 1986 sets out some of the reasons why the countervailing duty laws act as a buffer between various approaches to the role of government in society and should, therefore, not be lightly dismissed. A detailed post-Tokyo Round overview of the problems raised by attempts to negotiate international rules to regulate subsidies can be found in the proceedings of a 1981 conference edited by Don Wallace Jr., Frank J. Loftus and Van Z Krikorian, *Interface Three: Legal Treatment of Domestic Subsidies* (Washington: The International Law Institute, 1981).

[24] The softwood lumber case is treated in detail in Michael B. Percy and Christian Yoder, *The Softwood Lumber Dispute & Canada-U.S. Trade in Natural Resources* (Halifax: Institute for Research on Public Policy, 1987).

The first gap that will have to be bridged in the next phase of negotiations is the continuing different understanding of the problem by the two governments: is it the practice (subsidies) or the remedy (countervailing duties) that needs to be the focus of negotiation? To Canada, the remedy continues to be the main problem, even though the solution may lie in disciplining the practice. To the United States, the practice continues to be the problem, although a solution may lie in some discipline on the remedy. These differing points of departure can be traced to diverse attitudes of the two countries to the way government interacts with society, the different ways in which trade policy is formulated and executed as well as the disparate role of trade in the two economies. Each of these differences has sparked false perceptions in the two countries that must be thoroughly analyzed and understood before there can be any hope of progress in resolving the subsidies/countervail issue.

Attitudes, Myths and False Perceptions

Subsidies, Subsidies Everywhere: One of the most enduring modern myths is that nothing moves in Canada unless a government first pays for it, establishes it or provides an incentive. No one in Canada, according to this myth, ever does anything on his own initiative or without government assistance. The myth is more strongly held south of the border than in Canada, although some Canadians of a socialist or nationalist persuasion like to nurture it. They believe nothing should move unless government has first planned it and will move better if government is there to help. The reality, however, is a little different.[25]

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[25] US commentators frequently suggest that subsidization is largely a foreign problem; see, for example, Gary Hufbauer and Joanna Shelton Erb, *Subsidies in International Trade* (Washington: Institute for International Economics, 1984). There is no shortage of public sources which demonstrate the opposite. Among the most important are various

The myth is grounded in perceived differences in attitude to the role of government. Generally speaking, it is alleged, Canadians trust government and are suspicious of the market while Americans trust the market and are suspicious of government. Some have gone further and suggest that Canadians have tended to welcome government intervention in the market while Americans have relied more on private enterprise. From an appreciation of this difference, some analysts have concluded that Canadian business and society hardly moves without some government regulation or incentive prodding it along while American business has successfully kept government off its back and demonstrated the efficacy of free enterprise.[26]

This caricature is, of course, overdrawn. While there are clear distinctions between Canada and the United States, including attitudes to government, the differences are much more subtle. Both countries have relied on govern-

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studies by the Congressional Research Service (e.g., *The Subsidization of Natural Resources in the United States*, February 5, 1985) and the Congressional Budget Office (e.g., *Federal Support of US Business*, January, 1984). A handy overview is provided by Beryl Frank, ed., *Encyclopedia of US Government Benefits*, 11th ed. (New York: Dodd, Mead & Company, 1985). As a guide to US subsidy practices, the Trade Negotiations Office commissioned a survey conducted by the Institute for Research on Public Policy and the Government Research Corporation, *An Annotated Inventory of Federal Business Subsidy Programs in the United States*, available from the IRPP for a nominal fee. The main growth in US subsidies has been at the state level, for which see, *Directory of Incentives for Business Investment and Development in the United States*, prepared by the National Association of State Development Agencies, 2d ed (Washington: The Urban Institute Press, 1986); James Moses, *State Investment Incentives in the USA*, Economist Intelligence Unit Special Report No. 187 (London: The Economist, 1985); *Industrial Development and Site Selection Handbook*, Vol. 31, no. 5 (October 1986); John M. Kline, *State Government Influence in US International Economic Policy* (Lexington, Mass: D.C. Heath and Company, 1983). Equally, there are various sources of information on Canadian subsidy practices, such as J. Peter Johnson, *Government Financial Assistance Programs in Canada*, 3d ed (Toronto: Price Waterhouse, 1985), *Services and Subsidies to Business: Giving with Both Hands*, A Study Team Report to the Task Force on Program Review (The Neilsen Task Force) *(Ottawa: Supply and Services, 1986); Federal-Provincial Relations Office, Federal-Provincial Programs and Activities: A Descriptive Inventory* (Ottawa: Supply and Services, 1986). Older, analytical accounts can be found in Peter Morici and Laura L. Megna, US *Economic Policies Affecting Industrial Trade: A Quantitative Assessment* (Washington, National Planning Association, 1981) and Peter Morici, Arthur J. R. Smith and Sperry Lea, *Canadian Industrial Policy* (Washington, National Planning Association, 1982).

[26] US congressional consideration of the Canada-US trade negotiations and Agreement provided frequent examples of the continuing belief in the United States that subsidization is a Canadian practice and a problem for the United States. Similarly, much of the case by Canadian economic nationalists against the Agreement is based on this caricature of the differences between the two countries such as, for example, the essay by Pierre Berton in *If You Love this Country* (Toronto: McClelland and Stewart, 1986).

ment instruments to nurture economic development. The difference has lain more in the instruments used than in the extent to which government intervention has been tolerated (in the United States) or sought (in Canada).

Early American business relied on the tariff to shield it from foreign competition. Such tariffs constituted government intervention on a grand scale. The Smoot-Hawley Tariff Act of 1930 raised average rates to 60 per cent, but it was only the last in a long series of protectionist tariff bills. Not until the 1950s did average tariffs in the United States approach those that had been in effect in Canada from its inception. Only in the last 30 years have Canadian tariffs been higher than their American counterparts. When Canada and the United States signed their first ever bilateral trade agreement in 1935, the US MFN tariff on dutiable goods still averaged around 50 per cent, while that of Canada was around 30 per cent.[27]

The wealth generated by a protected industry, as well as land grants and favourable regulation, helped to develop the early American economy. But when the economy fell on hard times or a desired objective was not being met, US governments did not hesitate to step in with large government projects such as the Tennessee Valley Authority or the St. Lawrence Seaway. Thus, while the emphasis may have been on private enterprise, this was a private enterprise nurtured by government policy and protection and supplemented by government projects where necessary.

US government support for agriculture has been particularly acute and enduring. Starting in the 1930s, the US government introduced a range of policies to shield US farmers from world competition. By the 1950s these had become so extensive that the United States sought and received a waiver from its GATT obligations, such as they were, for its agricultural trade practices, thus institutionalizing for the United States the wholesale exemption of agriculture from GATT rules.[28] Other import sensitive sectors have similarly found the US government ready to assist when their circumstances changed and reduced tariff protection exposed them to greater international competition – the textile, steel, shipbuilding and automotive industries are but four of a longer list of industries that have benefited from quotas, subsidies, special antidumping measures, Buy America preferences and orderly marketing arrangements.

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[27] I am drawing here on a much more detailed comparison of the historical development of Canadian and US trade policy forming part of a book in progress.

[28] In the original GATT negotiations, the United States had already insisted on the inclusion of Article XI which provided signatories with the right to curb imports of agricultural products in conjunction with domestic production control programs. By 1955, even this provision proved insufficient to justify US protection of agriculture and the United States sought and received a waiver from these obligations. As well, Article XVI was amended to include a prohibition of export subsidies but not on primary commodities, i.e., agricultural goods. At the negotiations establishing the GATT as well as in 1955, the main protagonists in the drafting of the agricultural exceptions in Articles XI and XVI were the United States and Canada, with Canada seeking to narrow their scope. US criticism of Canadian agricultural trade practices, which are fully

In Canada, governments used a somewhat different policy mix. While the tariff was an important instrument as far back as the 1870s, from early days it was supplemented by creative administration, including the use of drawbacks, bounties and special duties, as well as preferences for Britain and other Commonwealth countries. Canada invented the antidumping system in 1904. In addition, given the vast size of the country and its sparse population, government financed large infrastructure projects, such as railroads and canals, to develop the interior and bring resource products to world markets. Like the United States, Canada founded state enterprises when it was clear that certain projects were too risky or expensive for private entrepreneurs.

By the beginning of the 1960s, Canada and the United States used very similar policy instruments to pursue trade and industrial objectives, although there were differing emphases in the use of those instruments. Canada continued to rely on the tariff for a longer period of time. The United States made much earlier and more inventive use of its tax system and of preferences in government purchasing. Canadian governments, faced with huge disparities in regional wealth and endowments, used grants and loans to induce regional development. The United States used its huge annual outlay on defence to nurture the development of certain industries.

Different attitudes and priorities in other policy areas were also apparent. While for the United States, defence was a high priority, Canada chose to develop a comprehensive medicare system. Where the United States decided to send a man to the moon, Canada decided it wanted to nurture the development of Canadian art and literature in order to bolster Canadian identity. While Americans tackled the problem of decay in their inner cities, Canadians attacked poverty in outlying regions.

In the 1970s and 1980s, as governments began to worry about deficits and the spiralling costs of the services they were committed to supplying, Canadian and US federal, provincial and state governments reviewed their priorities. Tax reform in the United States was one of the results – many of the

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consistent with US-sponsored loopholes in the GATT and did not require a waiver, tend, therefore, to have a hollow ring.

tax programs used in the past to benefit various industries were drastically reduced and other programs were cut back. Greater emphasis was placed on private enterprise. In Canada, governments tried to get a bigger bang for their regional development dollar, sometimes by spending less but talking more.

Because of these more recent differences, the view has spread that Canadian industries are much more dependent on assistance from the federal and provincial governments than their American counterparts. This issue was studied extensively during the course of the negotiations. While much more research and analysis could be undertaken, the tentative conclusion that can be drawn from the available evidence is that, while there are literally thousands of programs and policies at all levels of government to assist business in both countries, their overall impact is quite small. With the exception of big projects that gain a lot of media attention, such as efforts to attract automotive investments on both sides of the border, very few businesses are dependent on direct government assistance. If an incentive is available, business will take advantage of it. If it is not, not much will change.[29]

That is one conclusion. The second is that the impact of these policies and programs is uneven, both within each country and across the border. Both governments assist the agricultural sector, but they do not assist all the subsectors nor do they use the same instruments. The dairy sector on both sides is heavily subsidized but, whereas Canada uses supply management, the United States uses deficiency payments; both use import restrictions to back up these price support programs. Canada also uses supply management for poultry; the United States does not. The United States maintains artificially high domestic prices for sugar, cotton and peanuts combined with tight quotas on imports; Canada does not. Canadian provinces probably did not collect all the rents they could from their ownership of forests; American loggers relied on various tax schemes. American states attract auto investments with tax forgiveness, free training programs and infrastructure development; Ontario and Quebec use cheap loans and grants.

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[29] Examples of the relative insignificance of these subsidy programs can be gleaned from an analysis of the most important cases in the 1980s. In *Certain Fresh Atlantic Groundfish from Canada* (USITC Publication 1 844, May, 1986), 55 of 85 complained of programs were found to be countervailable, collectively amounting to 5.82 per cent *ad valorem;* the most significant was the 1.876 per cent assessment that federal equity infusions into National Sea Products and Fisheries Products International were not equityworthy, subsequently proven to be a questionable conclusion since both companies thrived following government-induced reorganization. In *Certain Live Swine and Pork from Canada* (USITC Publication 1 733, July, 1985)), 23 of 53 complained of programs were found collectively to confer a subsidy of 4.39 cents per pound. In *Softwood Lumber from Canada* (48 Fed. Reg. 1983, p. 24 168 and 51 Fed. Reg. 1986, p. 37 453), 27 programs were found countervailable, but only the inclusion of stumpage practices in the second case, at an arbitrary level, lifted the collective assessment above the 0.5 per cent *de minimis*, to 15 per cent, i.e., below the level of subsidization considered by US law to be injurious.

Thirdly, such programs and policies that do exist are more likely to be perceived to have a direct impact on bilateral trade if they are Canadian than if they are American. This has nothing to do with the virtues of the policies and programs or their extent and everything to do with the size of the two economies and the role of bilateral trade within them. In Canada, many companies export more than half of their production; some export as much as 90 per cent. The preponderance of these exports go to the United States. In the United States, on the other hand, it is a rare company that exports as much as half of its production and only a small percentage of that goes to Canada. Thus any Canadian program is likely to have, or will be perceived to have, a direct effect on exports to the United States, whereas US programs are likely to have an import displacement effect. In today's mercantilist world, export effects are recognized to be bad whereas import displacement effects are not. The first can lead to countervail, the second to gnashing of teeth.[30]

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[30] The GATT and the GATT Subsidies Code classify subsidies three ways:

- those that are unlawful, such as export subsidies on nonprimary products
- those that are lawful unless they cause serious prejudice to the export interests of exporters to third markets
- those that are lawful unless they cause material injury to competitors in an importing country.

Most subsidies are thus lawful but that lawfulness may be questioned if it causes harm. Harm is also classified in three different ways, based on their effect and the type of sanction that may be authorized:

- material injury, i.e., harm in the domestic market of an importing country which may lead to a unilaterally determined and imposed countervailing duty (based on GATT Article VI)
- nullification and impairment of expected benefits, i.e., harm in displacing imports in the subsidizing country which may justify multilaterally authorized countermeasures to restore the balance of benefits (based on GATT Article XXIII)
- serious prejudice, i.e., harm in displacing exports in third markets which may lead to multilaterally authorized countermeasures (based on GATT Article XVI).

These various distinctions are rooted in the GATT concept that the agreement involves a set of mutual and reciprocal balance of benefits. Very few practices are in fact a violation of the agreement. Rather, various national practices give rise to the right to seek a remedy if they cause harm. Only the first kind of harm has historically given rise to any serious jurisprudence and most of that jurisprudence is national. There is virtually no case history to provide any guidance as to what constitutes serious prejudice or nullification and impairment. Member states can thus unilaterally determine when a subsidy is lawful and when it is not, but only for one of the three types of harm for which GATT authorizes countermeasures. At the same time, there is no guarantee that any kind of subsidy is ever wholly lawful.

The lesson in this litany is that in both countries governments have played and continue to play a large role in society and have taken on an increasing number of responsibilities. Many government programs have intended or unintended trade and economic development implications: medicare results in a higher tax bill but a lower wage bill and lower overall costs to society; urban renewal nurtures different types of economic activity than does regional development; putting a man on the moon leads to different industrial spin-offs than does a program of cultural support. Differences between the two governments, therefore, lie not in whether governments intervene in society, but how, where and for whose benefit.

As an indication of orders of magnitude in federal spending in the two countries, it is instructive to compare annual federal budgets:[31]

- total outlays by the US federal government for 1985 were 24 per cent of the GNP or 20.7 per cent when interest payments on the national debt are omitted
- total outlays by the Canadian federal government for 1985 were 25.9 per cent of the GNP or 20.6 per cent when interest payments on the national debt are omitted
- nondefense spending by the US federal government was 14.3 per cent of the GNP compared to 17.7 per cent in Canada
- Canadian federal commitments in the area of social security were significantly higher than in the United States; overall government (federal and provincial) spending on social security in Canada in 1984-1985 represented 15 per cent of the GNP; the US equivalent was 9.7 per cent
- R and D expenditure by the federal government (military and civilian) in the United States is in the order of $50 billion, compared to less than $2 billion in Canada
- the Canadian federal commitment to cultural programs is in the order of $2.5 billion.

Nevertheless, proliferating countervail suits in the United States during the 1980s, all of which contained long lists of offending programs, reinforced the view that Canadian companies seemed to be able to compete only because of government assistance programs – somehow, Canadian companies were not only benefiting from a low dollar, but from unfair government assistance. These proliferating countervail suits, combined with antidumping and safeguard actions, as well as complaints about other unfair practices, nurtured a perception in Canada of a United States unprepared to tolerate differences and ready to lash out at foreign competition with its trade remedy laws. For Canadians, it was not subsidies that were a problem, it was the application of US countervailing duties that was unfair. Americans were using their courts to intimidate legitimate Canadian competition

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[31] These figures are based on an analysis of budget outlays for fiscal 1984-1985. An analysis of more recent outlays would not be significantly different.

Unfair Unfair Trade Laws: The second perception that needs to be placed into perspective, therefore, is the role of courts and tribunals in regulating behaviour. If Americans are convinced that Canadians thrive only because of a benevolent government, Canadians are equally convinced that Americans cannot settle an issue without going to court. Not only does this litigation result in black and white decisions, so the myth goes, but the deck has been stacked in favour of US producers when it comes to issues involving foreigners.[32] In Canada, on the other hand, some even believe that problems are settled calmly, behind closed doors, through rational discussion leading to compromises that satisfy everyone.

When it comes to trade, this particular perception has its roots in the different ways in which trade policy is formulated and executed in the two countries. Again, an appreciation of this difference will help to bridge the gap between the two governments in the search for a permanent solution to the subsidies/countervail problem.

Under the US Constitution, trade policy-making is the exclusive right of the Congress while foreign policy is the responsibility of the president. For many years, the main trade policy-making instrument was tariff legislation. Until 1934, the United States followed an independent, autonomous, non bargaining tariff policy. The US economy remained relatively isolated from the world economy behind a tariff wall unaffected by any international obligations or negotiations. In the hundred years prior to the Smoot-Hawley Tariff, the president had negotiated some 25 trade treaties but only 3 were ever ratified by the Senate (with Canada, Cuba and Hawaii).[33]

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[32] There are many problems with the US system; these must be seen within the context of their historical development and the peculiar relationship between Congress and Administration in the conduct of trade policy. Little is to be gained by diatribes against the US system based on a superficial understanding of its origins, development, operation and place in US policy-making, such as that of Alan M. Rugman and Andrew D. M. Anderson in *Administered Protection in America* (London: Croom Helm, 1987). Canadians need to understand that system and learn to work with it if they hope to negotiate a new approach. A more balanced account is I. M. Destler, *American Trade Politics: System Under Stress* (Washington: Institute for International Economics, 1986). An abbreviated version can be found in "Protecting Congress or Protecting Trade?" *Foreign Policy,* vol. 62 (Spring 1986), pp. 96-107. A somewhat more historical treatment is contained in Robert A. Pastor, *Congress and the Politics of Foreign Economic Policy 1929-1976* (Berkeley: University of California Press, 1980). The trade policy problem for smaller, trade-dependent countries like Canada were first raised by Rodney Grey. The most detailed statement of his thesis that the US trade remedy or contingency protection system has fundamentally altered the GATT-based trade relations system can be found in *United States Trade Policy Legislation: A Canadian View* (Montreal: Institute for Research on Public Policy, 1982).

In 1934, with passage of the Reciprocal Trade Agreements Act, Congress for the first time delegated its trade policy-making authority. The Act set broad goals and objectives which the president could achieve through reciprocal trade agreements. Adoption of the reciprocal trade agreements program marked a revolution in US trade policy. It radically altered not only the basic orientation of US trade policy (from a built-in bias favouring protectionism to one favouring liberalism), but also the process by which it was formulated and delivered. Congress now blessed the adoption of a "bargaining" tariff and delegated its power over the detail of tariff-making to the Administration.

As part of that delegation, Congress wrote detailed rules covering other terms of access for imports and assigned their administration to the courts and to quasi-judicial tribunals. Congress and the Administration would from now on rely heavily on detailed rule-making and legalistic administration of these rules. Additionally, Congress created private rights which could be pursued through legal channels. As a result, the details of trade policy-making would become a professional, nonpartisan activity pursued by the Administration and the courts within broad guidelines set by the Congress. No longer would Congress have to respond to the details of constituent complaints.

In the 1970s, the conditions which had created a liberal trade policy environment in the 1930s and 1940s lost force and relevance and US trade policy began to revert to its fundamental protectionist impulses. Sectors such as autos, consumer electronics, textiles and steel wilted before significant import penetration. Burgeoning trade deficits, and the re-emergence of Europe and Japan as major industrial powers, deprived the United States of unquestioned trade and economic dominance and revived the ancient mercantilist proposition that imports constitute strategic weakness and exports represent strength.

Over this period, the Congress began steadily to reassert its constitutional responsibilities for the conduct of US trade policy and became more receptive to protectionist initiatives. During the liberal aberration in US trade policy, the House Ways and Means and Senate Finance Committees had, apart from agriculture, almost exclusive jurisdiction over trade policy. Powerful chairmen such as Congressman Wilbur Mills and Senator Russell Long worked closely with the Administration to deflect or defeat protectionist legislation. By the 1980s, the decline in the authority of the congressional leadership to control legislation, the breakdown of party discipline, and the rising importance of individual Congressmen with strong, single-issue constituencies created a receptive environment for protectionist initiatives.[34]

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[33] John M. Letiche, *Reciprocal Trade Agreements in the World Economy* (Morningside Heights, New York: King's Crown Press, 1948).

The restoration of protectionism was paralleled by the steadily growing exposure of the US economy to world trade. In 1950, the United States exported just over 6 per cent of its production of goods. By 1980, exports accounted for almost 20 per cent of US goods production. Even more striking has been the rise in import penetration. In some sectors, including many consumer products, imports account for over half of the US market. This increase, most pronounced in the years since 1970, has coincided with almost annual US trade deficits. Between 1894 and 1970, the United States consistently ran a merchandise trade surplus. In every year but two since 1970, the United States has recorded a trade deficit.

US macroeconomic policies pursued throughout the Reagan years exacerbated the impact on US trade policy of structural changes in the US economy and further weakened the steadily diminishing constituency for a liberal trade policy. The greater economic importance of a strong trade performance and the seeming permanence of US trade deficits also eroded the legitimacy of deploying trade policy to serve broader US political and economic objectives. In the 1950s, for example, the United States lent strong support to the formation of the European Community, absorbing the costs of discrimination against US trade as the price of fostering a stable and more prosperous Europe. Thirty years later, the United States is no longer willing to accept discrimination against its exports to sustain important bilateral relationships, or indeed to maintain the multilateral trading system.

The main instrument of protection has become US trade remedy laws. These laws were enacted many years ago: the countervailing duty law in 1897; the modern antidumping duty law in 1921; and escape clause action in 1930. Since then, there have been many subtle changes in these laws and in their administration. During the period of liberal US trade policy, these laws shielded Congress from protectionist pressures by creating a statutory framework for US industries seeking relief from imports. Constituents could be sent 'downtown' to plead their case. The Congress was unwilling to change the basic remedies even if their application did not always provide relief to US industry.

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[34] See I. M. Destler, *American Trade Politics: System Under Stress* (Washington: Institute for International Economics, 1986).

But since the early 1970s, four omnibus trade bills (the 1974 Trade Act; the 1979 Trade Agreements Act; the 1984 Trade and Tariff Act and the 1988 Trade and Competitiveness Act) gradually made import relief more available and more certain and reduced Administration discretion to deny relief for foreign policy or other reasons.

As a result there has been a proliferating and aggressive use of trade remedy legislation by US industry. Prior to 1974, import-affected industries that sought relief under US law generally lost out. Between 1955 and 1968, 371 antidumping cases were investigated but duties were imposed in only 12 cases. Between 1934 and 1974, following more than two hundred subsidy investigations, the Treasury Department imposed countervailing duties only 41 times – about one successful case per year, many only lasting a few years. Between 1948 and 1974, the Tariff Commission investigated 143 claims for safeguard action, recommended relief 45 times and the president provided protection 18 times – about one escape clause action every other year. Concluded American scholar Mac Destler: "... in the first thirty postwar years, import affected industries that played the trade policy game by the legal rules, generally lost out."[35]

After the 1974 Trade Act, a more accommodating Administration attitude reflecting, and in part fuelling the rise of protectionism, made the launch of cases more profitable for domestic industry. By the 1980s, these had become a flood. Eight separate countervailing duty investigations were launched in 1980; 10 in 1981, 124 in 1982, 21 in 1983, 50 in 1984, 40 in 1985 and 28 in 1986. The value of trade covered rose fourfold from under $500 million prior to 1980 to over $2 billion in 1985. This increase has been paralleled on the antidumping side. Between 1980 and 1987, 40 antidumping, countervailing duty and escape clause actions were launched against Canada alone and 18 of these led to import restrictions imposed against Canadian exports to the United States.

The Administration argued that short bursts of protectionist energy would contain protectionist pressures in the Congress. Unless domestic industry obtained satisfaction from current law, the Administration argued, it would lose credibility and even worse law would emerge from the Congress. Hence it made sense to reinterpret existing law in selected cases even if the result was the application of import restrictions. The fair trade laws and the escape clause were thus portrayed as a kind of inoculation against a full-scale outbreak of protectionism.

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[35] I. M. Destler, *American Trade Politics: System Under Stress* (Washington: Institute for International Economics, 1986), p. 113.

The scope of cases expanded to cover relatively insignificant amounts of trade. Examples included cut flowers and egg cartons where the volume of trade investigated in both cases was under a million dollars. While the trade effect of such cases is slight, the psychological effect on Canadian exporters and investors was much greater. If small amounts of trade can be caught in the web, what could happen to significant trade volumes? The tale was told in lumber. In 1986, despite a 1983 case that did not find Canadian stumpage practices countervailable, a new petition was accepted and eventually led to a negotiated solution requiring Canada to impose a 15 per cent export tax on lumber.[36]

The combined effect of a more accommodating Administration, more aggressive use of the trade remedy legislation by industry and resurgence of congressional protectionism has resulted in the growing judicialization or legalization of US trade policy. Rather than one government addressing the complaints of its citizens to another government on the basis of international treaty rights, US citizens increasingly address their complaints directly to quasi-judicial domestic panels and the courts which try the issues on the basis of domestic law.

It is one thing if private rights reinforce treaty rights and obligations, it is quite another if the two diverge. In general, in extending these private rights, the US Congress has paid little heed to US international trade obligations. The basic framework predated the GATT and many new wrinkles adopted since filled vacuums in the GATT system or simply interpreted the GATT in new ways. Louis Sohn has noted that at present,

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[36] Even where cases are relatively insignificant either in terms of the volume of trade affected or the level of duties eventually imposed, the chilling effect on trade and investment decisions can be substantial. Notes US trade lawyer Gary Horlick: "Generally, once a government grant is allocated over total sales and amortized over the appropriate useful life, the resulting subsidy amount is very small. Thus the industry that brought the case often does not obtain any significant tariff benefit and the respondent industry may ultimately obtain a rate that is not a significant trade impediment, but at a heavy cost in terms of time, legal fees, and market uncertainty. In short, it is often a lose-lose situation for the parties." "The Free Trade Agreement Working Group: Developing a Harmonized and Improved Countervailing Duty Law," in American Bar Association Section of International Law and Practice, *United States/Canada Free Trade Agreement: The Economic and Legal Implications* (Washington, 1988), p. 405, footnote 5.

> ... in the gray areas where the rules are unclear, both the rules and remedies are provided mostly by national legislation and national courts, to the great dissatisfaction of the other country which considers it below its dignity and a violation of the sovereign equality of states that the court of another country would judge the validity of its acts and would take steps against its nationals on the basis of its own legislature's interpretation of the applicable [international] rules.[37]

Thus the legalization of US trade policy has opened a fertile field for trade disputes. Where necessary, the US government has negotiated changes, or tried to negotiate changes in the international rules to conform to changes in US domestic laws and practice. Failure to update the international rules to conform to US law and practice, however, did not always result in changes in US law and practice, again increasing the scope for international dispute.

Canadian trade policy developed differently, although eventually many of the same basic policies were adopted but with one large difference: the Canadian Parliament shied away from creating private rights. In Canada's parliamentary system, trade policy-making and treaty-making resides in a Cabinet responsible to an elected House of Commons. As long as the Cabinet enjoys the confidence of the House, it has tremendous power. Since there is no separation between the legislature and the executive, the Cabinet has great latitude in formulating and executing policy. It can do so less openly than in the US system and it can exercise tremendous flexibility and creativity. It can artfully combine international negotiations and domestic policy-making. And it jealously guards its power, rarely delegating authority to the courts or quasi-judicial tribunals. The extensive private rights enjoyed in the United States, encouraging a high resort to judicial resolution of trade disputes, is alien to the Canadian system. Rather, it places a much greater reliance on negotiation and compromise. Even the Special Imports Measures Act of 1984, which largely follows US precedent, leaves a larger measure of discretion to the federal Cabinet than do its American analogues.

The search for a new trade remedy regime during the bilateral negotiations brought these two systems into conflict. Canada was prepared to use its negotiating flexibility to alter the Canadian system as necessary if Americans were prepared to deal with their system. Canadians had had enough of what to them seemed a system out of control. More and more new laws seemed to give their US competitors ammunition with which to lash out at them for what appeared to be flimsy excuses. Even where Canadian exporters were vindicated, the cost of fighting cases undermined their position in the US market. The very existence of these US laws discouraged Canadian producers and exporters from venturing into the US market. They also constrained, for better or worse, government initiatives promoting "industrial policy." To Americans, however, Canadians were attacking a system that had provided the underpinning for a liberal trade policy. Without the safety valve of private rights and remedies against "unfair" foreign competition, it was claimed, the United States would not have been able to bring its tariff down to its current insignificant level. Many US commentators continue to believe that US trade policy is fundamentally liberal, despite mounting evidence to the contrary, and that it is the failure of other countries to restrict unfair trading practices that has forced the United States to strengthen its trade remedy system.[38]

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[37] Louis B. Sohn, "Dispute Resolution Under a North American Free Trade Agreement" *Canada-United States Law Journal*, vol. 12 (1987), p. 323.

For Canadians, the challenge was clear. In a bilateral negotiation aimed at removing all remaining tariff and other customs barriers, it would be unacceptable for the United States to retain the right unilaterally through its courts and legislation to determine which domestic Canadian policies would be tolerated and which would be penalized. There had to be a better way. That better way was not found during the initial phase of the negotiations and Canadians had to be satisfied with an interim solution. Yet, unless the next phase of the negotiations eventually brings major reforms to the unilateralism inherent in the US system, there is little hope for a lasting solution to the subsidies/countervail quandary.

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[38] US economists have long identified the protectionist effect in the rising increase in resort to trade remedy law. Unlike Canadian law, US law does not include a provision allowing consumers and industrial users to petition for a reduction in the duties. See, for example, the pioneering work of J. M. Finger, H. Keith Hall and Douglas R. Nelson, "The Political Economy of Administered Protection," *American Economic Review*, 72, no. 3 (June, 1982) and Gary Clyde Hufbauer, Diane T. Berliner and Kimberly Ann Elliott, *Trade Protection in the United States: 31 Case Studies* (Washington: Institute for International Economics, 1986). An older, critical examination of US trade remedy legislation, pointing out many of its protectionist biases, can be found in Stanley D. Metzger, *Lowering Nontariff Barriers: US Law, Practice, and Negotiating Objectives* (Washington: The Brookings Institution, 1974). Similar concern about the implications of the 1979 Trade Agreements Act were expressed by Peter Ehrenhaft in "What the Antidumping and Countervailing Duty Provisions of the Trade Agreements Act [Can] [Will] [Should] Mean for US Trade Policy," *Law and Policy in International Business*, vol. 11 (1979). Nevertheless, US legal periodicals continue to be filled with articles by practitioners, officials and congressional aides pointing out that the laws are not tough enough and need to be strengthened, presumably because industries that feel threatened by imports believe that they have not received all the relief to which they should be entitled.

The Negotiating Issues

A Problem of Definition: From a purely economic point of view, subsidies and other government intervention measures distort the free operation of the market. Subsidies have a similar effect to tariffs. They distort prices or profits and thus provide some producers with an ability to compete internationally not commensurate with their efficiency or productivity. Tariffs distort trade by increasing prices and thus decreasing consumption, while subsidies distort trade either by increasing exports or displacing imports. But not all subsidies distort international trade. From a policy point of view, therefore, the problem is defining what constitutes a trade-distorting government subsidy or defining what is a tolerable level of foreign government subvention and determining what is an appropriate response to such distorting policies. Writes international trade scholar John Jackson:

> Domestic or general subsidies ... are an important tool of government policy. They are used extensively by all governments, and often for laudatory policy goals, such as redressing unfair imbalances of income, alleviating distress of poverty, or pursuing democratic priorities of various types such as cultural, religious, national or security goals. They are mixed deeply into the fabric of national sovereignty. In those cases the objectives of international trade rules to minimize market distortions must be balanced against the competing legitimate government goals.[39]

The question, therefore, is not whether the United States or Canada do or should use subsidies or other economic intervention programs to further economic development and other objectives, but rather coming to grips with what are trade-distorting forms of intervention and what are not. At issue is whether in a free trade area, one party should unilaterally determine, through the use of its countervailing duty law, what is an acceptable subsidy. A central negotiating problem, therefore, is developing common definitions of what constitute trade-distorting practices and agreeing on appropriate disciplines to control such practices which can be applied jointly rather than unilaterally.

Reaching an internationally agreed definition as to what constitutes a countervailable (i.e., prejudicial and injurious) subsidy has proven an elusive goal. GATT Article VI states "the term 'countervailing duty' shall be understood to mean a special duty levied for the purpose of offsetting any bounty or subsidy bestowed, directly or indirectly, upon the manufacture, production or export of any merchandise" (Article VI:3 and repeated in the GATT Subsidies Code). Throughout the 1970s during the negotiation of the Subsidies Code and the 1980s in an experts group, GATT contracting parties sought to develop more precise guidelines. To date these efforts have not met with success. Individual governments have filled this void with their own definitions in domestic statutes and, more importantly, through administrative decisions and procedures.[40]

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[39] John H. Jackson, "Achieving a Balance in International Trade," *International Business Lawyer*, April 1986, p. 125.

US Law and Practice: The US government has developed the countervail instrument into a fine art. Being the only serious practitioner of countervail, developments in US law and practice have had a decisive impact on how countervailing duties (CVDs) are viewed. Until 1974, the United States applied its CVD statute narrowly, limiting it to export subsidies conferred on goods dutiable under US law; there was no requirement to prove injury. The extension of CVDs to duty-free goods (provided for in the 1974 Trade Act) and to domestic subsidies (the Michelin radial tire case in 1973) increased pressure to add an injury test (as required by the GATT and achieved as part of the Tokyo Round negotiations).

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[40] **Canadian definition**: "'Subsidy' includes any financial or other commercial benefit that has accrued or will accrue, directly or indirectly, to persons engaged in the production, manufacture, growth, processing, purchase, distribution, transportation, sale, export or import of goods, as a result of any scheme, program, practice or thing done, provided or implemented by the government of a country other than Canada, but does not include the amount of any duty or internal tax imposed on goods by the government of the country of origin or country of export from which the goods, because of their exportation from the country of export or country of origin, have been exempted or have been or will be relieved by means of refund or drawback" (Section 2 (1) of *Special Import Measures Act*).

US definition: The term 'subsidy' has the same meaning as the term 'bounty or grant' as that term is used in section 1303 of this title, and includes, but is not limited to, the following:

'(A) Any export subsidy described in Annex A to the Agreement (relating to illustrative list of export subsidies).

'(B) The following domestic subsidies, if provided or required by government action to a specific enterprise or industry, or group of enterprises or industries, whether publicly or privately owned, and whether paid or bestowed directly or indirectly on the manufacture, production, or export of any class or kind of merchandise:

'(i) The provision of capital, loans, or loan guarantees on terms inconsistent with commercial considerations.

'(ii) The provision of goods or services at preferential rates.

'(iii) The grant of funds or forgiveness of debt to cover operating losses sustained by a specific industry.

'(iv) The assumption of any costs or expenses of manufacture, production, or distribution' (section 1677 (5) of *Tariff Act of 1930*).

No Canadian product was subjected to countervailing duties until the Michelin tires case in 1973,[41] although there had been previous complaints and procedures, the most celebrated being the threatened countervail suit against various automotive duty remission programs which led to the negotiation of the Autopact.[42] The Michelin case, however, marked not only the first CVD involving a Canadian product, but the first CVD involving domestic subsidies. The case involved both federal and provincial programs designed to offset the disadvantage of locating in a remote region. The case was vigorously defended by Michelin and dragged through the courts for almost 10 years. Duties were suspended in 1980 due to lack of injury (a requirement which needed to be met as a result of the Tokyo Round negotiations). The precedent, however, of countervailing domestic subsidies had, by that time, been firmly set.

A series of further Canadian cases confirmed the expanding US definition. Regional grants became a definite target (confirmed in the Glass Beads from Saskatchewan case and three groundfish cases). In 1979, Canada was again involved in a precedent-setting case: optic liquid level sensing devices exported by Honeywell Canada exposed government programs designed to encourage industrial research and development. The specific program involved was the Program for the Advancement of Industrial Technology (PAIT) which included forgivable loans used to finance product and market development for the application of new technology. Again, a vigorous defence by Honeywell and strong representations by the federal government did not deter the US from imposing a countervailing duty and further enlarging the ambit of the CVD statute.[43]

Since 1980, 14 more countervailing duty cases have been filed against Canada, increasing anxiety in Canada about the security of its access to the US market and raising concern about the ease with which the countervailing duty statute can be used to harass legitimate competition. One was terminated at the preliminary determination stage when the International Trade

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[41] Decision in 38 Federal Register of January 8, 1973. See also Robert V. Guido and Michael F. Morrone, "The Michelin Decisions: A Possible New Direction for US Countervailing Duty Law," *Law and Policy in International Business,* vol. VI (1974), pp. 237-266 and Rodney deC Grey, *United States Trade Policy Legislation: A Canadian View* (Montreal: Institute for Research on Public Policy, 1982). Grey was the senior Canadian official involved in discussions with the United States regarding the Michelin case.

[42] See Carl E. Beigie, *The Canada-U.S. Automotive Agreement: An Evaluation* (Montreal: Canadian-American Committee, 1970), pp. 38-39.

[43] Optic Liquid Level Sensing Systems from Canada, 44 Federal Register, no. 5 (January 8, 1979).

Commission found no evidence of injury; four were terminated at the final determination stage when the Department of Commerce found insufficient evidence of subsidization; two were settled before the final determination stage; one was terminated at the final determination stage due to lack of injury; six involved the imposition of final duties (live swine, but not dressed pork; whole fish but not fillets; oil country tubular goods; fresh flowers; steel rails; and prok products); and the second softwood lumber case was settled on the basis of a bilateral agreement whereby Canada agreed to impose a 15 per cent export tax. The total of 20 cases since 1974 demonstrated the wide range of goods and programs potentially liable to countervailing duties. It has also demonstrated the potency of the countervailing duty statute as a tool for harassment. Of the 20 cases, only 6 passed all hurdles and two of them only partially, but in all 20 cases, exporters incurred high costs in defending their interests.[44]

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[44] The 14 cases since 1980 involved:

1. Hard-Smoked Herring Fillets (1981). No duty imposed due to a negative preliminary determination on injury by the International Trade Commission.
2. Rail Passenger Cars and Parts (1982). No duty imposed as US complainant terminated the investigation by withdrawing its petition.
3. Softwood Lumber (1982). No duty imposed; countervailable subsidies were determined to be at *de minimis* levels. The complaint focused on Canadian stumpage practices which were not found to constitute countervailable subsidies.
4. Softwood Shakes and Shingles (1982). Same as Softwood Lumber.
5. Softwood Fences (1982). Same as Softwood Lumber.
6. Live Swine and Fresh, Chilled and Frozen Pork (1984). Duties imposed on live swine at 4.39 per cent, but not on pork, as imports of the latter were found not to have injured US producers. Has now been reduced to 2.2 per cent as a result of a review in 1988. Breeding animals are not affected.
7. Red Raspberries (1985). No duties imposed as investigation was suspended by mutual agreement between US and Canadian producers. Under the agreement, the BC government agreed not to provide the offending subsidies to Canadian exporters.
8. Oil Country Tubular Goods (1985). Duties of 0.72 per cent imposed.
9. Fresh Atlantic Groundfish (1985). Duties imposed on fresh fish at 5.82 per cent but not on fish fillets, as the latter were found not to have injured US producers.
10. Softwood Lumber (1986). No duties imposed as the complainant terminated the investigation by withdrawing its petition after an agreement was signed between the Canadian and US governments, whereby a 15 per cent tax was imposed by Canada on exports to the US, following a preliminary determination that stumpage practices constituted a countervailable subsidy. In addition, the Canadian government undertook to negotiate an increase in stumpage fees with the appropriate provincial governments. The increase is to have the same effect on Canadian exports as the export tax it will eventually replace.
11. Fresh Cut Flowers (1986). Duties of 1.47 per cent imposed.
12. Probe Thermostats (1988). Final negative on both subsidy and injury.
13. Steel Rails (1988). Duties of 103.55 per cent imposed.

The ever-expanding ambit of the US CVD statute was confirmed not only in case law but also in congressional pressures to make the law even wider in application. The statute does not define what constitutes a countervailable subsidy. Rather, it provides three statutory tests which must be satisfied in order for a CVD to be applied. The International Trade Administration of the Department of Commerce must first determine whether in fact a subsidy exists, i.e., whether a benefit exists. This is known as the preferentiality test. It must then determine whether the program is countervailable, i.e., whether it meets the specificity or general availability test. Only if a preference is granted to a narrower group than all is the specificity test satisfied. Finally, the International Trade Commission must determine whether the subsidy causes material injury to domestic producers. All three tests are vague and provide wide scope for administrative and judicial discretion. Their vagueness has led not only to domestic litigation but also to intergovernmental dispute as well as to domestic pressures to broaden their ambit and make resort to the remedy more certain. Additionally, the process is adversarial and quasi-judicial and, once initiated, does not provide the government with any discretion. There is no "public interest" feature as there is in Canadian law.[45]

Canadian Law and Practice: Canada added a provision for countervailing duties to the Customs Tariff Act in 1955 (section 7) but did not introduce regulations to make it effective until 1977. Under the 1984 Special Import Measures Act, the government for the first time provided detailed legislation for the imposition of CVDs. The decision to include detailed provisions for imposing CVDs was not unrelated to a perceived need to arm the Canadian government with similar powers to that of the US government.

Canada has made relatively infrequent use of CVDs. The first case was brought in 1979 and involved baler twine from Brazil, Mexico and Tanzania. No duties were imposed. There have been a number of cases since, mostly involving agricultural imports from the EC (cheese, beef, wine, pasta). The first case involving the United States occurred in 1986 (grain corn). Duties were later reduced as a result of appeals by users and consumers under the public interest provisions of Canadian legislation. This is only the second time ever that the United States has been at the receiving end of a formal subsidy complaint. The other case was brought by the EC and involved petrochemical feedstock benefiting from the dual pricing of natural gas. It was settled before

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14. Pork Products (1989). Duties of 3.8 cents per pound imposed.

[45] The *Special Import Measures Act* provides for the views of consumers and users as well as that of the Director of Investigations under the *Competition Act* to be taken into account and allows the Tribunal to reduce duties as a result. In the corn countervail case, user views were instrumental in reducing the level of the duty.

any duties were imposed and was related to the aggressive US reaction to a UK safeguard measure involving imports of American carpet fibres derived from this feedstock. In other words, the case was unusual and did not result from industry complaints or considerations of injury.

A Problem of Distortion: Theoretical discussion, statutory language and administrative practice all suggest that it is very difficult to develop a satisfactory definition of what constitutes a subsidy. Since the concern is that certain policies and programs significantly distort trade, the emphasis, therefore, ought better to concentrate on developing mutually acceptable criteria as to what types of programs distort trade.

The problem is that the trade-distorting effect of subsidies is often perceived to be directly related to a country's export performance. In a small country, such as Canada, exporting a narrow range of products representing a large proportion of total production, almost any domestic subsidy is likely to have a direct impact on exports. In calculating its export effect, the margin is likely to be sufficient to breach the *de minimis* threshold (0.5 per cent in the United States). For a large industrial economy such as the United States, subsidies are distributed over a much wider range of sectors, industries and regions. Exports represent a relatively small proportion of total production. The average margin on exported products, therefore, is likely to be small and will only rarely breach the *de minimis* threshold (there is no statutory threshold in Canada, but in antidumping cases margins as high as 9 per cent have been found to be insignificant[46]). It is not an accident that the first countervail case involving the United States was in the agricultural sector where the level of subsidization is high, the range of affected products is narrow and the exported quantities are relatively large.

It would be a mistake, however, to conclude from this state of affairs that subsidization in the large economy is not trade distorting. The distortion in the small economy is likely to be in its export effect. The distortion in the large economy is likely to be in its import displacement effect or in its ability to stimulate product innovation and variety. It is not neutral or benign.

Nevertheless, the problem of coming to grips with the problem of distortion ought not to be regarded as insoluble. Progress can be made by classify-ing government programs in terms of a number of criteria and agreeing that certain types of programs do not constitute significantly trade-distorting subsidies. Some examples might make this clear.

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[46] In Plywood Concrete Forming Panels, for example, dumping margins ranging from 2.3 per cent to 9.5 per cent were considered negligible by the Canadian Import Tribunal. In addition, the existence of high margins has not automatically led to findings of injury. In Optical Contact Lenses, for example, no injury was found despite a 63 per cent dumping margin.

Both in the United States and Canada, governments have small business and affirmative action programs. By their very nature, they create some preference and are specific, yet they are unlikely in most instances to lead to any significant trade distortion. Does a lower tax rate for companies employing fewer than a hundred people, for example, distort trade? Do low-interest loans to farmers distort trade? Do business development grants for natives distort trade? Answers to such questions will begin to narrow the field where discipline may need to be applied.

A second set of criteria might involve the purpose for which incentives are developed. Is the subsidy geared to broad objectives or does it have very narrow goals? Do tax credits for pollution abatement equipment distort trade? Does the building of a new access road to a mine distort trade less than the building of wharfs for fishermen? Are market development grants more distorting than R and D grants?

A third set of criteria could zero in on the type of program or instrument involved. Is a grant more distorting than a tax write-off? Do higher tariffs for one industry than for another constitute a subsidy? Under what circumstances does a loan constitute a trade distorting subsidy? Does government equity participation in a company immediately give rise to concern?

Finally, questions might well be asked as to what kind of distortion is important. Is the concern harm to competitors or harm to the economy? Do programs that maintain an inefficient inshore fishery in Canada constitute harm to the Maritime economy or to New England fishermen?

These are the kinds of issues with which the negotiators will have to wrestle if a satisfactory, long-term solution is to be found. Domestic subsidies potentially involve a vast range and number of government policies and programs, many of which are perfectly justifiable as an exercise of sovereign activity within a country. They are an integral aspect of each country's basic social and economic fabric. Reaching agreement on which of these practices are to be acceptable and which are not will require a high degree of consensus on a wide array of social and economic issues. It is unrealistic to expect such consensus to be reached quickly and easily.

At the same time, it is worth keeping in mind that most economists agree that the greatest amount of harm caused by subsidies is in the economy providing the subsidy. The decision to provide a subsidy is usually based on a political rather than an economic perception that the market allocation of resources in a particular circumstance is unsatisfactory and needs to be corrected with some form of government assistance – whether to compensate for the disadvantage of locating in a less than prime location, to encourage a particular economic activity, to maintain incomes at a desired level or some other goal. The economic effect is to reduce resources where they would have been allocated by the market and allocate them where it is perceived to be politically advantageous. The effect is to redistribute wealth and reduce overall economic welfare. Goods and services that are able to be exported because they are cheaper increase the economic welfare of the importing country, although individual producers in the importing country may be adversely affected. Over time, both the subsidizing and other economies adjust to compensate for the effect of the subsidy. Richard Cooper concludes:

> ... in the case of government subsidies, and other actions that influence international trade, the interests of other countries reside in the proposition that they should not have to bear the costs, which are often transitional or adjustment costs, arising from the actions of other countries. ... perhaps we should not worry so much about government subsidies to economic activity – or rather government intervention of all types – as far as their effects on foreign trade are concerned, provided that they do not impose acute adjustment costs on economic activities outside the country in question.[47]

A new approach would thus recognize that it is neither necessary nor practical to condemn all subsidies *per se*. There is no reason, for example, for new rules to take a dim view of adjustment assistance to firms, which meets a socially desirable objective. Nor is a useful purpose served in outlawing subsidies aimed at promoting environmental responsibility or cultural autonomy. Negotiations would have to proceed, therefore, on both the practice and the remedy. The key to any long-term solution would require reaching agreement on which kinds of subsidies are actionable and which are not, accompanied by clear procedural and substantive limits on how countermeasures are to be applied, taking due account of the fact that harm may be caused in either the importing or subsidizing country. Progress toward that goal will make it easier either to reduce the scope for countervail or to eliminate it altogether.

When all is said and done, however, the Working Group on subsidies is dealing with a very politically charged issue, as Canadians discovered during the 1988 election campaign. The ability of governments to use subsidies to promote national objectives and pursue democratically determined priorities cannot simply be negotiated away. The GATT Subsidies Code explicitly recognizes that subsidies serve important and legitimate national objectives, even where they may harm others. Canadians reacted angrily to suggestions that the subsidies negotiations might undermine the ability of the federal and provincial governments to pursue regional economic development or income redistribution programs. While there has never been any serious suggestion that either multilateral or bilateral negotiations would compromise the ability of governments to establish general social or economic welfare programs, the dividing line between these and specific industrial assistance programs which are the focus of international negotiation is not always easy to define. Thus concerns about national sovereignty will always trouble international subsidy negotiations.[48]

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[47] Richard N. Cooper, "US Policies and Practices on Subsidies in International Trade" in Steven J. Warnecke, ed., *International Trade and Industrial Policies* (New York: Holmes & Meier, 1978), pp. 119-120.

A Problem of Enforcement and Sovereignty: Whether or not Canada and the United States are able to work out the problems of definition and distortion, they will in any event have to devise a long-term regime that is enforceable. In an international context, that means that both sides have to be convinced that whatever rules are negotiated will be applied fairly and evenly and that failure to live up to any new disciplines can be resolved on the basis of rules rather than on the basis of power. This will require that the dispute settlement provisions of the Agreement work quickly and well and are seen to be fair and evenhanded. Disputes as to whether a particular program is or is not a subsidy or is causing bilateral trade distortion will thus need to be resolved by a mechanism that inspires confidence. Experience with the FTA's dispute settlement provisions should demonstrate whether they meet that test before any new obligations are undertaken. If they do not, part of the subsidies/countervail negotiations may well entail further discussion of the dispute settlement provisions of the Agreement.

Any strengthening of the dispute settlement provisions, such as, for example, by substituting a permanent tribunal for the current ad hoc panels, or broadening access to binding arbitration, will inevitably raise the issue of the extent to which either government is prepared to cede decision making to an international body. Judgements about whether either government is prepared to do this will again depend on whether new rules are seen to be substantially superior to the existing interim regime and likely to bring clear political and economic benefits.

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[48] The narrowness of this dividing line can be illustrated by the US industry's complaint against Canadian unemployment insurance practices in the 1986 Atlantic Groundfish Case. The complaint was not that Canadian unemployment insurance in general constituted a subsidy but that the special provisions for fishermen, extending more relaxed eligibility criteria, constituted a preference and was, therefore, a countervailable subsidy. The Commerce Department in this instance disagreed but might well agree at some point in the future.

A Problem of Negotiation: A major obstacle to negotiating a satisfactory solution to the subsidies/countervail problem arises from the fact that Canada is a relatively small, trade-dependent nation, with its exports heavily concentrated in a narrow range of products exported to one big market. The United States, on the other hand, is significantly less trade-dependent and additionally is a major power with worldwide responsibilities. Thus, in addition to the mercantilist perception that an export enhancement effect is an international issue while an import displacement effect is a domestic issue, there is the problem that a solution with Canada may be a problem for the United States. In general, Canadian negotiators do not have to spend much time worrying how a solution with the United States may set a precedent. As long as the solution is an improvement over the *status quo*, it is a positive precedent. But for the United States, while it may be satisfied that the solution is desirable in the Canada-US context, it may not be prepared to extend that solution to others, and the others constitute 80 per cent of its trade (compared to Canada where the others constitute only 20 per cent). American negotiators thus spend a lot more time looking over their shoulder while Canadians bull ahead in their bilateral discussions, oblivious to the rest of the world.

The problem, of course, is not insoluble but means that the perceived benefit to the United States of any particular solution has to be significantly more than marginal or the solution has to be perceived to be patently unique to the Canada-US context and not readily applicable elsewhere. A US commitment to eliminate subsidies in the agricultural area, for example, while eminently sensible and desirable, may be a hard sell to US farmers unless the EC makes similar commitments; but the EC is not a party to the bilateral negotiation. Disciplining specific industrial subsidies would undermine US negotiating leverage in GATT and give other GATT members a free ride. Again, while such discipline may be highly desirable from an economic point of view, in a world of mercantilist bargaining the price may be perceived to be too high.

Finding Satisfaction in a Second-Best Regime

Canada and the United States may not be able to solve all these problems. It may not prove possible to develop a satisfactory definition of subsidy; it may not be possible to come to a common understanding of what are trade-distorting practices; and either government or business may decide that the benefits of a new regime are outweighed by the increased discipline it requires. Members of the GATT have searched for a solution to these issues for the past 20 years and have not found one. While it may be easier to resolve the issue bilaterally, the conceptual and negotiating problems remain formidable.

Failure to achieve the widely perceived ideal solution does not mean that improvements cannot be made to the interim regime. There have been many suggestions made over the years how to make US countervailing duty procedures less easily used as a tool for harassment while maintaining discipline on truly offensive subsidy practices. Some of these would bring US law and practice closer into line with the intent of the GATT Code while others would go further. The fact that the two governments have already adopted an interim regime which admits that there needs to be improvements and which introduces the concept of bilateral review provides an important point of departure.[49] Indeed, some commentators have suggested that the two governments forgo the search for the ideal or fundamental solution and move immediately to the negotiation of improvements in current domestic countervail procedures building on the provision for bilateral review.[50]

It may prove desirable, for example, to rely on a permanent bilateral tribunal and extend to it authority now vested in domestic bodies. Both governments may be prepared to let such a bilateral tribunal determine the question of material injury after domestic tribunals have determined the question of subsidy. It may be possible to go even further and let a bilateral tribunal take on both functions: establish facts and the economic effect. Much can be achieved by replacing unilateral administration with bilateral determination.

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[49] US Department of Commerce official Stephen Powell, in this vein, told an audience of Washington lawyers and lobbyists in early 1988 that the interim regime "puts to rest the notion that the trade remedy laws, particularly the antidumping and countervailing duty laws, are untouchable." ("Antidumping Law and the United States-Canada Free Trade Agreement: Possible Next Steps," in American Bar Association Section of International Law and Practice, *United States/Canada Free Trade Agreement: The Economic and Legal Implications* (Washington, 1988), p. 417).

[50] For a detailed exposition of the improvements of the interim regime over the system that prevailed before the agreement went into effect, see Gary N. Horlick and Debra A. Valentine, "Improvements in Trade Remedy Law and Procedures under the Canada-United States Free Trade Agreement" in Donald M. McRae and Debra P. Steger, eds, *Understanding the Free Trade Agreement* (Halifax: Institute for Research on Public Policy, 1988) and Gary N. Horlick, Geoffrey D. Oliver and Debra P. Steger "Dispute Resolution Mechanisms" in Jeffrey J. Schott and Murray G. Smith, eds, *The Canada-United States Free Trade Agreement: The Global Impact* (Ottawa and Washington: Institute for Research on Public Policy and Institute for International Economics, 1988).

This solution may prove more or less attractive depending on the experience with the system of ad hoc panels established in the interim regime.[51]

Additionally, it may be possible to adjust the substantive rules. Various specialists have, over the years, produced a whole catalogue of reforms that would reduce the worst features of the current regime.[52] Some of those worth pursuing include:

- It may prove acceptable, for example, to establish different thresholds in the bilateral context than generally by raising the *de minimis* level to a cumulative 5 per cent or leave it at 0.5 per cent but calculated on an individual program basis.
- Similarly, it may be possible to adopt a threshold requiring that complaints about Canadian or US goods will be accepted only where they constitute a minimum percentage of the import market.
- The two governments may wish to agree on a more rigorous definition of material injury to be applied either by a bilateral tribunal or panel or by domestic tribunals to cases involving the other country.
- It may prove acceptable to require establishment of a stronger causal link between the subsidization and injury by requiring that the injury be directly attributable to the subsidization or that subsidization be the major cause of any injury.
- It may be possible to agree that the Canada-US dimension of any multiple-source complaint be severed and handled separately, i.e., that Canadian or US goods would no longer be cumulated with goods from other sources.

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[51] See W. Frank Stone, "Institutional Provisions and Form of the Proposed Canada-U.S. Trade Agreement" IRPP Discussion Paper 8604 (April 1986), pp. 21-24 for a detailed exposition of this bilateral administration option.

[52] See, for example, Murray Smith, *Bridging the Gap: Trade Laws in the Canadian-U.S. Negotiations* (Toronto: C.D. Howe Institute, 1987); Arnold and Porter, *United States Trade Remedy Law*, a report prepared for the Department of External Affairs, September, 1985; Paul Wonnacott, *US-Canadian Interdependence: The Quest for Free Trade* (Washington, Institute for International Economics, 1987); Roland Behm, "A Proposed Modification of US Import Relief Measures in the Context of a U.S.-Canada Free Trade Agreement: Safeguard, Countervail and Antidumping," *Georgia Journal of International and Comparative Law*, vol. 17, no. 1 (1987); and Gary Horlick, "The Free Trade Agreement Working Group: Developing a Harmonized and Improved Countervailing Duty Law" in American Bar Association Section of International Law and Practice, *United States/Canada Free Trade Agreement: The Economic and Legal Implications* (Washington, 1988).

- Both governments may require that complainants have clean hands, i.e., be free of any subsidies of their own, or, alternatively, that only the net difference between the respective levels be countervailed.
- It may also be helpful to require complainants to post bonds which they forfeit if the case is not proved – after all, the problem of subsidization is not a criminal matter but a civil matter and a major problem is that frivolous complaints, which cost the plaintiff much less than the defendant, chill trade and investment.
- It may prove helpful to require plaintiffs to establish that they represent the majority of the complaining industry.
- Requiring consultations involving respondents, plaintiffs and the investigating authorities before a case is formally initiated may clear up misunderstandings and misperceptions and also avoid frivolous cases.

In short, there is much that can be done to improve current domestic laws to make them less mercantilist or xenophobic and more attuned to the special circumstances of the North American market and the FTA. That is the challenge that the two governments will address over the next five to seven years.

While in the final analysis it may not prove possible to negotiate the ideal solution to the subsidy/countervailing duty conundrum and the two governments may well decide to live with an improved version of the interim solution, by the time that decision is reached, two developments should have taken place that should strengthen confidence in the benefits of the Agreement and make it possible to live with what may at first seem a failure. First, the two governments and business will have had seven years of experience with the Agreement. Most tariffs will be gone by then and most of the rules will have been thoroughly tested. There will, additionally, have been seven years of experience with the improved dispute settlement provisions. Second, progress should have been made on some of the other issues that remain on the negotiating agenda, either bilaterally or multilaterally. Finally, the Working Group is likely to have made more progress on the second issue with which it is charged, the development of a substitute regime to deal with unfair pricing practices where the issues, while complex, are not as politically charged.

Anticompetitive Pricing Practices [53]

While progress on the subsidy/countervail issue may prove slow and frustrating, there is no reason why substantial progress cannot be made within the five- to seven-year time frame of the Working Group in developing a substitute regime to deal with anticompetitive cross-border pricing.[54] During the 1980s, a growing number of commentators have taken an interest in the disparity between domestic antitrust law and international antidumping law and have suggested that as economies become more integrated and competition more intense, there is need to resolve this disparity. Generally speaking, this difference arises out of the fact that antitrust law protects consumers and seeks to promote domestic competition while antidumping law protects competitors and promotes the interests of domestic producers. Many antitrust experts and economists find this contradiction disturbing and have suggested that governments move toward a more rational international regime for regulating anticompetitive pricing.[55]

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[53] This section is drawn from a more detailed exposition of the issues raised by antidumping provisions in free trade areas prepared for a study edited by John H. Jackson and Edwin A. Vermulst, *Antidumping Law and Practice* (Ann Arbor: University of Michigan Press, 1989).

[54] The preponderance of attention on the mandate of the Working Group established by Article 1907 has been on subsidies. Post-FTA articles that have looked at the unfair pricing dimension include Stephen Powell, "Antidumping Law and the United States-Canada Free Trade Agreement: Possible Next Steps," in American Bar Association Section of International Law and Practice, *United States/Canada Free Trade Agreement: The Economic and Legal Implications* (Washington, 1988) and Douglas E. Rosenthal, "Antitrust Implications of the Canada-United States Free Trade Agreement," *Antitrust Law Journal*, vol 57 (1988), pp. 485-496.

[55] See, for, example, papers presented at a Conference on Competition and Dispute Resolution in the North American Context reproduced in the *Canada-United States Law Journal*, volume 12 (1987), particularly papers by Lawson Hunter, Doug Rosenthal, Joel Davidow and Calvin Goldman. Also of interest on evolving views on domestic price discrimination are Robert Bork, *The Antitrust Paradox: A Policy at War with Itself* (New York: Basic Books, 1978) and Terry Calvani and James M. Lynch, "Predatory Pricing under the Robinson-Patman and Sherman Acts: An Introduction," *Antitrust Law Journal*, vol. 51 (1982) for the United States and Donald G. McFetridge and Stanley Wong, "Predatory Pricing in Canada: The Law and The Economics" *The Canadian Bar review*, vol. 63, no. 4 (1985) and R.D. Anderson and S.D. Khosla, "Recent Developments in the Competition Policy Treatment of Predatory Pricing" *Canadian Competition Policy Record* (Ottawa, Consumer and Corporate Affairs, 1986) for Canada. Comparisons of Canadian, Mexican and US approaches to antitrust are provided in James W. McKie, "An Antimonopoly Policy for North America: Opportunities and Problems," and Peter C. Carstensen, "Competition Policy for an Economically Integrated North America," both in *Law and Contemporary Problems*, vol. 44, no. 3 (1981). A paper commissioned by the Canadian Department of Consumer and Corporate Affairs for consideration by the

The Canada-US trade negotiations benefited from much of this scholarship. American antitrust scholar Douglas Rosenthal, for example, has noted "that the Free Trade Agreement (and the Working Group it creates) provides an extraordinary opportunity for melding the concerns of trade and competition law. It is no longer utopian to contemplate the possibility that Canadian and American trade and antitrust laws, which are substantially congruent, can be applied in a manner that is substantially harmonious."[56]

Most experts agree that dumping is rare in a free trade area once the tariff and other barriers to the free movement of goods have been eliminated. The rationale for maintaining an antidumping regime, therefore, becomes considerably weaker.[57] The issue that needs to be addressed is whether, for the few remaining instances of cross-border price discrimination, it is necessary to retain access to antidumping provisions or whether to extend the national treatment principle even further and rely on domestic competition rules. As long as antidumping provisions are available, they retain their potential for harassment and discrimination.

During the negotiations, the two sides completed a technical examination of the issues involved in relying on competition law but did not reach a policy decision. Given that work would need to continue on subsidies and countervailing duties and that during the transition regime there would continue to

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OECD Committee on Competition Policy by Rodney Grey, "Trade Policy and the System of Contingency Protection in the Perspective of Competition Policy" (OECD Document DAFFE/RBP/WP1/86.3) provides a detailed overview of the differences between competition law and trade policy. Another paper commissioned by CCA, Klaus Stegemann, "The Consideration of Consumer Interests in the Implementation of Anti-dumping Policy" was prepared for a 1984 OECD Symposium on the Consumer Policy and International Trade; similar views are expressed in his "Anti-dumping Policy and the Consumer" *Journal of World Trade Law*, vol 19 (1985), pp. 466-484. See also Michael S. Knoll, "United States Antidumping Law: The Case for Reconsideration," *Texas International Law Journal*, vol. 22 (1987), pp. 265-288 and Thomas J. Schoendam, *Antidumping and Countervailing Duties and the GATT: An Evaluation and a Proposal for a Unified Remedy for Unfair International Trade* (Athens, Georgia: Dean Rusk Center for International and Comparative Law, 1986).

[56] Douglas E. Rosenthal, "Antitrust Implications of the Canada-United States Free Trade Agreement," *Antitrust Law Journal*, vol. 57 (1988), p. 488.

[57] This is now being recognized in Europe after more than 30 years of experience with free trade regimes. See EFTA Document W9/87 of 3 March 1987 "Competition Rules Instead of Antidumping Rules in EFTA-EC Trade," note by the Swedish Delegation; John Temple Lang, "European Community Antidumping and Competition Laws: Their Actual and Potential Application to EFTA Countries" prepared for the EFTA Secretariat; and Sven Norberg, "European Community Antidumping and Competition Laws: Their Actual and Potential Application to EFTA Countries: Some Comments from an EFTA point of view."

be barriers making dumping easier, the interim CVD regime was, therefore, extended to dumping on the understanding that work would also continue on establishing a post-transition regime based on competition principles.

Since there are differences between Canadian and US laws dealing with price discrimination and predation, particularly in respect of the procedures and remedies available to private parties, the two governments will need to develop compatible procedures and standards, although these would not necessarily require that each country use precisely the same criteria in the application of its laws. A comparison of Canadian and US competition laws suggests: [58]

- Existing laws on predatory pricing would require only minor changes to make them applicable to cross-border predatory pricing.
- Price discrimination laws, which bear the greatest similarity to the type of situation presently covered by antidumping laws, would be more easily perceived by business and legislators on both sides of the border as a "substitute" for antidumping law than would the use of predatory pricing laws alone .
- Existing Canadian and US laws on price discrimination would need some changes to make them applicable to transborder trade by eliminating several significant differences in substance, and restricting their cross-border application to anticompetitive situations in primary line cases (i.e., limiting complaints to discrimination at the seller's level).
- Given the similar stages of development of the laws in both countries, it is feasible to use either predatory pricing laws exclusively, or both price discrimination and predatory pricing laws to deal with objectionable pricing practices of a cross-border nature.
- Differences in administration and procedure, including scope for private action and government investigation, are not sufficiently large to become a hindrance to their application to cross-border pricing practices, although there would be need for some common rules to reduce jurisdictional conflicts, to facilitate the gathering of evidence and to recognize and enforce judgments.

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[58] The following points are drawn from a detailed comparison of Canadian and US price discrimination laws by Lawson Hunter and Douglas Rosenthal commissioned by the Government of Canada, the main findings of which are reported in Mark Gillen, Lawson Hunter, Douglas Rosenthal and Todd Miller, "Canadian and US Antitrust Law – Areas of Overlap Between Antitrust and Import Relief Laws" *Canada-United States Law Journal*, volume 12 (1987), pp. 39-74.

- Rules governing choice of forum, choice of law, or both might be considered in order to limit forum shopping or discourage unnecessary parallel litigation.
- Rules would be required to avoid conflict arising from transborder investigations involving government-conducted criminal or civil suits or private antitrust actions.
- The present treble-damages rule in US antitrust law presents a serious obstacle to more summary recognition and enforcement of remedies in cross-border cases of price discrimination or predatory pricing.
- Special rules might need to be developed to deal with the effect of third-country price discrimination, a situation not contemplated in existing national laws dealing with either dumping or price discrimination

Given these differences, much technical work would be required before either government would be ready to concede that it is ready to move to a competition regime. Among the most critical issues that would have to be addressed are as follows:

Relationship to Dispute Settlement Mechanism: it will be necessary to provide for recourse to the dispute settlement provisions of the Agreement, as well as to define the circumstances in which recourse would be available. The dispute settlement provisions of the Agreement provide for the settlement of disputes between the two governments arising out of their obligations under the Agreement. These provisions thus lend themselves to disputes about subsidies and countervailing duties which at heart involve distortions in trade generated by government programs. Dumping, however, is a private practice and only involves governments in the application of antidumping measures. The role of binational dispute settlement, therefore, will need to be carefully defined, particularly if the two governments move toward a regime based on domestic competition law largely administered by the courts, often as a civil matter. Consideration may thus be required, in light of the experience of the first few years, whether the dispute settlement provisions are adequate and appropriate for the settlement of disputes involving cross-border anti competitive pricing.

Choice of Jurisdiction: In order to prevent concurrent or consecutive proceedings in both countries, forum shopping, or conflicting judgments, there would need to be criteria to guide the private parties, tribunals and other bodies in both countries in deciding whether a specific complaint should be pursued in one country or in the other. The criteria could be based on the general principle that the forum with primary interest has jurisdiction. The guidelines could also prescribe that jurisdiction properly seized in accordance with agreed criteria would be of an exclusive nature as far as a particular complaint is concerned.

Choice of Law: In order to provide tribunals with enough flexibility to deal with complaints involving single markets spanning two national jurisdictions, or multiple markets in different national jurisdictions, there would need to be guidelines concerning the substantive laws that the tribunals should apply in particular cases.

Standing: Canadian and US firms, as well as their respective governments, would have to be given the right to trigger the competition laws of the other country, when in compliance with the rules governing choice of forum.

Fact-Finding Procedures: In order to facilitate either civil discovery or government investigations, agreement would be required to define the obligations of the authorities and tribunals of one country concerning requests from the other country for information found within its territory. This would be particularly important in cases where the requests are compulsory. The guidelines would extend to the manner in which information is exchanged between enforcement agencies in both countries and could build upon existing understandings between the two countries (e.g., the Memorandum of Understanding as to Notification, Consultation and Cooperation with respect to the Application of National Antitrust Laws and the Treaty on Mutual Legal Assistance on Criminal Matters).

Jurisdiction Over Defendant: Rules would be needed to achieve effective jurisdiction over defendants located in one country, in actions properly initiated within the jurisdiction of the other country.

Recognition and Enforcement of Remedies: Agreement would be needed to define the manner in which remedies properly decreed in one country would be recognized and enforced in the other country without undue delay.

Time Limits for Completion of Proceedings: Consideration would have to be given to establishing rules governing the time during which the entire process, or segments thereof, should be concluded.

The development of a new, competition-based regime to replace anti-dumping provisions, therefore, is relatively straightforward although technically and legally complex. The conceptual issues are not difficult. Furthermore, much progress has already been made at the technical level and it should be possible to overcome some of the remaining technical problems relatively quickly. The process of negotiating such a new regime will be aided by the experience gained in living with the Agreement.

Intellectual Property Rules [59]

Intellectual property, i.e., patents, copyright, trade marks and trade secrets, was a weighty matter for the United States. Consideration in the negotiations of the US desire to strengthen the protection of intellectual property through bilateral agreement broke new ground in free trade negotiations and was based on the changing nature of commercial policy. Specialized knowledge is one of the main building blocks for future economic growth. Barriers to access to that knowledge can, therefore, be just as detrimental to the development of advanced technology industries and modern service industries as barriers to market access. In addition, barriers to the latest, most efficient technology can have an impact on the competitiveness of potential users in the resource processing and traditional manufacturing industries. Finally, trade-related intellectual property matters touch on some of the most deeply rooted and least tangible aspects of our society such as culture and commercial reputations as well as on the most dynamic and future-oriented elements of the economy.

As the largest owner of intellectual property rights in the world, the United States had a natural interest in seeking to raise the level of intellectual property protection in Canada. In the area of patents, the United States had long sought resolution of its concerns with respect to compulsory licensing of pharmaceutical patents. In the copyright domain, the United States had several outstanding concerns with Canadian law, including the lack of explicitly legislated protection for computer programs, semiconductor computer chips, and cable retransmission rights. In the trademark area, the United States wanted to have the name "American Bourbon" protected by regulation under the Canadian Food and Drugs Act. With respect to both copyright and trademarks, the Americans sought stiffer criminal sanctions for infringement of rights.

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[59] On intellectual property and modern trade negotiations, see Helena Stalson, *Intellectual Property Rights and US Competitiveness in Trade* (Washington: National Planning Association, 1987). Some of the negotiating issues are set out in Michael Hart. "Canada-US Trade Negotiations and the High-Technology Industries," *CIPS Review*, January/February, 1986. For a US view, see Harvey E. Bale, "The Links Between Investment, Intellectual Property, and Trade," *Economic Impact*, no. 55, 1986, pp. 30-35 and United States Trade Representative, *Administrative Statement on the Protection of US Intellectual Property Rights Abroad*, April 17, 1986.

Canada, of course, had its own interests. Under free trade conditions with the United States, Canada would require an environment wherein inventors could see the prospect of obtaining appropriate rewards from the marketplace for their work. More importantly, protecting intellectual property raises the issue of access to technology which in turn raises the sensitive question of export controls barring access to such technology. The intellectual property discussions were largely driven by US interests, but Canada had its own interests to pursue and was not adverse to a balanced package covering intellectual property matters.

But the FTA does not include a chapter on intellectual property rules. It should have and was intended to have such a chapter. A working group had made good progress on such a chapter but, at the last minute, US insistence on resolving the pharmaceutical issue on its terms doomed the chapter. In trade negotiations, sometimes the hardest decision to make is whether half a loaf is better than no loaf, particularly when, for a long time, one has insisted on a whole loaf. In the case of intellectual property, the United States chose no loaf; in the case of trade remedies, Canada was prepared to settle for half a loaf. International negotiations are a matter of making incremental changes and improvements. Major changes such as the Canada-US Agreement are the exception. In most cases, half loaves (such as the GATT) often prove very nourishing.

All that the FTA now states on intellectual property generally[60] is that the two governments will cooperate in the GATT and elsewhere to improve the protection of intellectual property. In effect, the two governments recognize that the issue continues to need to be addressed. More likely than not, unless there is major breakthrough at the Uruguay Round, it will have to be addressed in bilateral negotiations over the next few years. Continued and rapid developments in advanced technology will keep the issue alive and urgent in the Canada-US bilateral context.

The negotiating issues will remain the same. If progress is to be made, however, it should be made on the merits of general propositions rather than individual irritants. Irritants in trade policy serve the useful purpose of drawing attention to an issue and keeping it there, but trade law made on the basis of individual irritants is not likely to endure. Both governments have done their homework and resolution will depend on the political desire to settle the issues. In mercantilist bargaining, that will mean that the United

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[60] Article 2004. The issue of the trade name "Bourbon Whiskey" is resolved in Article 806 and a long-standing irritant involving cable retransmission is addressed in Article 2006.

States, the main demandeur, will have to demonstrate that it has satisfied Canadian interests elsewhere.

Services

The FTA is pioneering in that it contains the first ever set of general rules covering trade in services.[61] The Australians and New Zealanders have subsequently added an even more extensive code on trade in services to their 1983 free trade agreement. Additionally, the Uruguay Round of multilateral trade negotiations will try to establish general rules for all GATT members. All of this is good news for those who favour non-discriminatory trade rules and liberal trading conditions.

The bad news is that the FTA rules do not go very far. All that they require is that the two governments, as well as state and local governments, in their future regulation of services, not discriminate in favour of local suppliers. As far as existing rules and regulations are concerned, the two governments agreed that any changes in these rules and regulations would either maintain nondiscrimination or not introduce any greater discrimination. Canada would be able to challenge the United States were it, for example, to extend its trade remedy laws to services because to do so would introduce an element of discrimination that does not now exist.

These obligations are not very onerous, especially if one keeps in mind that they apply only to those services specifically enumerated in an annex to the chapter. The rules do not apply to all services. The challenge for the future, therefore, is twofold. The first is to broaden the coverage of the chapter. Transportation services, for example, are not now covered. There is no contractual obligation on either government preventing it from establishing rules discriminating in favour of local suppliers of transportation services. The second challenge will be to identify those areas where government regulations and programs in the services area currently do discriminate in favour of local suppliers and negotiate the reduction or elimination of such barriers.

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[61] For a discussion of the role of services in the international economy and the agenda for international negotiations, see the *Background Report* of the Canadian Task Force on Trade in Services (October 1982); the US submission to the GATT, US *National Study on Trade in Services*; M. G. Clark, *The GATT and Trade in Services*, IRPP Discussion Paper (Ottawa: Institute for Research on Public Policy, 1985); Rodney Grey, "A Not-So-Simple Plan for Negotiating Trade in Services," mimeograph; Ronald K. Shelp, *Beyond Industrialization: Ascendancy of the Global Service Economy* (1981) and "Trade in Services," *Foreign Policy*, no. 65, Winter 1986-87, pp. 64-84; Helena Stalson, US *Service Exports and Foreign Barriers: An Agenda for Negotiations* (Washington, National Planning Association, 1985); Raymond J. Krommenacker, *World-Traded Services: The Challenge for the Eighties* (Dedham, Mass: Artech House, 1984); and Janette Mark, *Trade and Investment in Services: An Issue for the 1980s* (Ottawa: North-South Institute, 1984).

The Agreement, therefore, provides a framework of principles and rules and a program for negotiating the gradual reduction or elimination of barriers to trade in services just as the GATT provided a framework of principles and rules and a program for negotiating the gradual reduction or elimination of barriers to trade in goods. Fortunately, there are few barriers to trade in services; the obligation to negotiate, therefore, is not a heavy obligation. In effect what the obligation does is provide an incentive for the private sectors in both countries to identify any barriers or impediments, bring them to the attention of the two governments and encourage them to use the provisions of the Agreement to negotiate their elimination.

Like the antidumping, intellectual property and government procurement provisions calling for continued negotiations, the provision calling for continued bilateral discussions to broaden and deepen the obligations in the services chapter provide an opportunity for the two governments to demonstrate their continued commitment to manage change constructively and to build a shared stake in the continued well-being of the Agreement and the North American economy.

Institutional Machinery

Implementation of the Agreement required not only that the two governments take the necessary steps to complete their domestic legislative procedures, but also jointly to establish the necessary institutional and administrative machinery to make the Agreement work. To date, they have appointed a Canadian and US secretary and have named rosters for the appointment of panelists under Chapters 18 and 19. More generally, however, they will need to consider to what extent they want to take advantage of the opportunity provided in the Agreement to establish more permanent bodies and appoint nongovernmental advisory bodies and working groups.

The essential features of the institutional provisions are described in the Government of Canada's official explanatory notes as being "economy, joint decision-making and effective dispute resolution."[62] In the views of many critics, economy is not the right word. They are downright miserly. In the views of these critics, in order for the Agreement to work, more robust, permanent machinery will be required. In the words of Robert Hudec, "… it is at least an empty bottle into which the parties could one day pour some wine."[63] It would not be surprising, therefore, to see further discussion over the years to establish a permanent and independent secretariat to take on many of the tasks now assigned to the two governments, as well as a permanent trade tribunal to deal with the adjudication of disputes.

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[62] External Affairs Canada, *The Canada-U.S.Agreement: Synopsis* (Ottawa: Supply and Services, 1987), p. 48.

Additionally, the ongoing discussions on subsidies and unfair pricing in the Working Group established in Chapter 19, as well as other continuing negotiations, should identify specific deficiencies and suggest improvements that need to be made in the institutional provisions. Here again, there will be opportunity to let the Agreement evolve and grow and thus build further confidence and commitment to the principles of the Agreement.

An important challenge for the two governments is to learn to use the dispute settlement provisions of the Agreement as they were intended. There is always great temptation to resort to dispute settlement on a difficult political issue that could not be resolved through negotiation. Neither the Chapter 18 nor the Chapter 19 provisions, however, are capable of resolving issues for which the Agreement does not spell out clear rules. Issues which were not resolved through negotiation can only be resolved through continuing negotiation, not through dispute settlement.

Long-Term Implications of a Two-Track Trade Policy

The fact that the two governments have built into the FTA an ambitious program for continued negotiations illustrates the extent to which the FTA has ushered in a two-track approach to trade policy in both countries. It will be interesting to see how this evolves over the next few years. The success of the FTA and of this two-track approach to trade policy will thus depend not only on the FTA's long-term impact on economic and political developments in the two countries and on the ability of the two governments to use its various provisions to improve and strengthen trade and economic relations between the two governments, but also on its impact on the further evolution of the international trading system. This final section briefly assesses how these critical aspects of the Agreement will interact and influence the continuing negotiating agenda.

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[63] Robert E. Hudec, "Comments" on Gary N. Horlick, Geoffrey D. Oliver, and Debra P. Steger, "Dispute Resolution Mechanisms," in Jeffrey J. Schott and Murray G. Smith, eds, *The Canada-United States Free Trade Agreement: The Global Impact* (Ottawa and Washington: Institute for Research on Public Policy and Institute for International Economics, 1988), p. 91-92. See also the comments by Frank Stone on the same article. For a dissenting view, see L. H. Legault, "Institutions and Settlement Procedures under the Canada-U.S. Free Trade Agreement" in Donald M. McRae and Debra P. Steger, eds, *Understanding the Free Trade Agreement* (Halifax: Institute for Research on Public Policy, 1988).

Economic Impact

Most immediately, the success of the Agreement will depend on its economic impact. Econometric modeling suggests that the removal of protection on both sides of the border should lead to a 2-3 per cent increase in Canadian GNP and about a half per cent increase in the United States.[64] There are good reasons, however, to expect higher results.

The FTA catches up to the economic and business realities of the Canada-US trade and investment relationship. By guaranteeing more open and more secure access to businesses on both sides of the border, it should allow both countries to plan and grow with increased confidence. Early evidence that the FTA is meeting this economic objective can be seen in the changed attitudes among Canadian entrepreneurs. Canada may be dependent on exports for 30 per cent of its GNP, but traditionally exports have been confined to a narrow range of products. Additionally, many Canadian companies viewed themselves as order takers rather than as involved in international business. In short, many sectors of the Canadian economy did not view their business as international or took the steps necessary to become successful on a worldwide basis. Over the past few years, however, the business pages of Canada's newspapers have shown a remarkable change in these attitudes, changes directly attributable to the debate over the Canada-US negotiations and their positive result. An increasing number of Canadian companies, including those already involved in exporting, now acknowledge the need to become more internationally competitive, to rationalize their production and to produce products for the world market rather than only for the Canadian or North American markets. They have accepted the challenge to diversify, establish joint ventures, enter into licensing arrangements and distribution networks and establish branch plants or subsidiaries to an unprecedented extent. They now view the US market as only an intermediate step to the world market.

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[64] The most detailed post-agreement modeling was done by the Economic Council of Canada and the Canadian Department of Finance. The findings of the ECC are summarized in Economic Council of Canada, *Venturing Forth: An Assessment of the Canada-U.S. Trade Agreement* (Ottawa: Supply and Services, 1988). The Finance findings are in *The Canada-U.S. Free Trade Agreement: An Economic Assessment* (Ottawa: Department of Finance, 1988).

The economic success of the Agreement will require greater rationalization and specialization which in turn should lead to an increase in intra-industry trade and even intra-firm trade. This level of success will be evident if Canadian trading patterns diversify – not as a result of a reduction in trade with the United States but because of an increase in trade across the Atlantic and Pacific due to greater competitiveness and specialization. The ultimate economic success of the Agreement, therefore, will require the successful implementation of outward-looking, international business attitudes. The dynamism resulting from these changed attitudes will lead to much more wealth creation than the mere removal of tariffs. Such changes cannot be captured in econometric models and these models are consequently too conservative in their estimates of the long-term economic impact of the Agreement.

The success of the continuing negotiations will depend critically on the Agreement generating this type of dynamic economic adjustment. The success of the GATT during its first 20 years was in large measure the result of the steady growth in international trade in the 1950s and 1960s, a growth stimulated by the liberalization sponsored by the GATT. The problems that have beset the GATT in the last 20 years can be in part attributed to the slowdown in growth and in the transition of the GATT's focus from trade liberalization to trade management. Adjustments leading to a 2 or 3 per cent increase in the GNP will not be sufficient to maintain the degree of political and business support necessary to make progress on government procurement, unfair pricing and intellectual property and, of course, subsidies and countervailing duties. These issues were not resolved during the initial negotiations because they are difficult and involve a higher degree of political risk than some of the provisions that were agreed upon. They have not been resolved multilaterally for similar reasons. Governments will be unwilling to take such risks unless the Agreement is a sufficient success to disarm critics, including those that may be hurt by the adjustment process.

Political Impact

At a second level, the success of the Agreement will be measured in terms of its political impact. The test will be whether the Agreement improves the North American trade policy and trade relations environment by reducing conflict, encouraging steps to avoid disputes, and inspiring more rapid dispute resolution. It would be naive to expect an absence of trade and investment issues and of irritants between the two countries. In an economic relationship where more than $200 billion in goods and services are exchanged annually and capital flows freely across the border, there are bound to be differences – but the test will be whether the irritants are resolved more quickly, more professionally and more amicably. In short, the Agreement will have to prove enforceable and raise a minimum of friction. Early proof will be seen in the approach of the two governments to the establishment of panels and their attitudes to the reports and recommendations of these panels. Early, mutually satisfactory resolution of some conflicts through the panel process under both Chapters 18 and 19 will help. Early opportunities will be afforded by current differences over the definition of wool and the long-standing irritant of differing plywood standards. As noted by Leonard Legault, former legal advisor in the Department of External Affairs and now Minister Economic in Washington:

> The Canada-US Free Trade Agreement ... is a striking achievement as it stands. It brings under the discipline of agreed rules an economic and trade relationship of unique closeness and complexity. It gives the relationship a greater mutuality and defines a common object and purpose for the parties. It provides the parties with the means to ensure implementation of the Agreement and to manage their relationship more effectively, in particular by means of a pioneering system of dispute avoidance and dispute settlement. ... The provisions of the Agreement relating to ... the avoidance and settlement of disputes ... are of critical importance. If these work, the Agreement works.[65]

A related test is whether the Agreement will lead to an attitude which assumes a greater degree of political cooperation; will the Congress and provincial governments, for example, pursue their trade and investment objectives unilaterally or cooperatively? Will frustration over new issues lead to the unilateral use of section 301 in the United States or to blocking legislation in Canada or to mutually satisfactory negotiation? In short, will the institutional provisions of the Agreement be allowed to work, grow and develop or will efforts to enforce the Agreement be seen as acts of provocation and infringement of sovereignty? In the past, the smooth operation of the GATT process has been hampered because requests for panels were regarded as provocative. Should such an attitude prevail under the FTA, the system will not work. But should a spirit of bilateral cooperation prevail, the Agreement will meet its second test for long-term success.

Again, the development of such a political attitude of cooperation and a sense of mutuality by politicians and officials on both sides of the border will increase the chances of success in pursuing the continuing negotiating agenda. Failure to make proper use of the institutional provisions and an attitude of skepticism and irritation about their use will doom further negotiations.

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[65] L. H. Legault, "Institutions and Settlement Procedures under the Canada-U.S. Free Trade Agreement" in Donald M. McRae and Debra P. Steger, eds, *Understanding the Free Trade Agreement* (Halifax: Institute for Research on Public Policy, 1988), p. 21.

Impact on International Trade Relations System

Finally, the FTA's long-term success, and that of the continuing negotiating agenda, will be determined by the extent to which it will prove to be a positive force internationally. Will it become a complement and catalyst to international negotiation and cooperation or will it be seen as an alternative or substitute for multilateral bargaining and cooperation? This is a larger problem for Canada than for the United States. For Canada, the FTA has become its primary trade policy instrument, governing as it does, at least for the immediate future, 80 per cent of Canadian exports and imports. For the United States, the FTA covers only 20 per cent of its trade and is thus a secondary instrument to the GATT. Both countries, however, attach considerable importance to the multilateral system and to their participation in the GATT.

Narrowly focused, there is no question that the FTA is GATT legal. No other free trade agreement notified to GATT comes as close to meeting the requirements of Article XXIV.[66] But GATT compatibility is more than a question of meeting the letter of Article XXIV. Also important to the future evolution of the GATT is whether the FTA will advance or derail the further elaboration of the GATT principles of nondiscrimination and trade liberalization. The FTA is itself neutral. The question will be determined by subsequent policy development pursuant to the FTA as well as Canadian and US participation in the GATT process. Just as the Treaty of Rome was a catalyst to the Dillon and Kennedy Round negotiations and EC expansion to include the UK, Denmark and Ireland a catalyst to the Tokyo Round, the Canada-US FTA may prove to have been a catalyst to the Uruguay Round. This is not an issue, however, over which Canada and the United States have perfect control. It will depend in part on the response of other major players to the challenge of rebuilding and expanding the GATT system. It is an open question whether the EC, Japan and the major LDCs share Canadian and US ambitions for the multilateral system.[67] Nevertheless, should the GATT process prove rewarding, then the FTA could prove to have been a catalyst. Notes US antitrust expert Douglas Rosenthal:

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[66] On the question of the requirements of GATT Article XXIV, see Michael Hart, "GATT Article XXIV and Canada-United States Trade Negotiations," *Review of International Business Law*, vol. 1, no. 3 (December, 1987), pp. 317-355 and Philip Raworth, "Economic Integration, the GATT and Canada-United States Free Trade," *Ottawa Law Review*, vol. 18, no. 2 (1986), pp. 259-308. There is as yet no comprehensive review of the compatibility of the text of the FTA with the provisions of the GATT.

[67] For a review of EC, Japanese and LDC attitudes to the GATT and a new round of negotiations, see Michael M. Hart, *Canadian Economic Development and the International Trading System* (Toronto: University of Toronto Press, 1985), pp. 43-51.

> It would be wrong to view the FTA as hostile to the further development of multilateral trade institutions: it does not establish a fortress North America. On the contrary, it is a commitment to reason and order which can provide a model, a testing ground, and a source of renewed energy for extending and improving both the work of the GATT in the Uruguay Round and other bilateral economic relationships.[68]

Nevertheless, the FTA does mark a softening of Canadian and US commitment to multilateralism. By entering into the Agreement, the two governments recognize that the GATT cannot be expected to resolve all bilateral trade and economic problems. Some Canadian and US critics of the FTA have thus argued that the very fact that Canada and the United States have entered into this agreement undermines the multilateral system. This need not be the case in the long term. There are many unique aspects of the Canada-US relationship that the GATT process has been unable to address and which were successfully resolved by the FTA. Insisting that they could only be addressed multilaterally is to insist that they not be resolved, to the detriment not only of Canadian and US entrepreneurs but also of the multilateral system itself.[69] The governments that drew up the GATT 40 years ago accepted that there were situations where regional arrangements would both introduce discrimination and lead to increased world trade. Geography as well as a high degree of integration among business and capital markets made a Canada-US free trade agreement a logical choice. With the possible long-term exception of Mexico, neither Canada nor the United States are likely to seek other free trade agreements unless the current GATT round proves a failure. Only in such an event is the Canada-US FTA likely to stimulate more bilateral experiments and undermine multilateralism.[70]

A more interesting question is whether the lessons of the FTA can be applied more generally or can governments go this far only in the unique context of two countries already closely integrated and sharing many similarities in attitudes and approach. Does the increasing political resistance to adjustment as well as greater economic disparity at the multilateral level rule out comprehensive multilateral agreements on such sensitive domestic issues as industrial policy, subsidies, investment, performance requirements, product standards and government procurement? Must the increased range of issues in modern negotiations be addressed both regionally and multilaterally and lead to an increasingly tiered international trade relations system? Is the multilateral system, at least for the time being, stretched as far as it can go? In the Canada-US FTA there is a commitment to address these issues bilaterally. In Europe, the combined effect of the Treaties of Rome and Stockholm and the free trade agreements that link the two groups together amount to a similar commitment. Efforts to address these issues multilaterally have so far come up short. Can these regional arrangements and their more far-reaching commitments effect greater policy uniformity and less discrimination than has so far been possible under GATT? While the ultimate goal should be universal rather than regional rules, progress and experience at a regional level may be the only way to get there. It is the gradual response to these challenges, both bilaterally and multilaterally, that will determine the long-term international impact of the Canada-US FTA.

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[68] Douglas E. Rosenthal, "Antitrust Implications of the Canada-United States Free Trade Agreement," *Antitrust Law Journal*, vol. 57 (1988), p. 486.

[69] The issue is discussed in more detail in the final chapters of the revised edition of W. F. Stone, *Canada, the GATT and the International Trading System*, forthcoming from the Institute for Research on Public Policy.

[70] See Jeffrey J. Schott, *Free Trade Areas and U.S. Trade Policy* (Washington: Institute for International Economics, 1989) and a forthcoming study prepared for the Council on Foreign Relations under the editorial direction of Peter Morici, both of which consider the likelihood of the United States entering into more free trade areas, particularly with Mexico, and the implication of such agreements for the future evolution of the GATT and US trade policy.

Canada and the United States will address the continuing international trade policy agenda on two tracks -- bilaterally under the FTA and multilaterally under the GATT. These efforts should be mutually reinforcing with the lessons learned in one negotiation applied to the other. Ultimately, it would desirable if the two countries can conclude that the FTA is no longer necessary because more universal rules are equally beneficial. Until that day comes, the FTA and its agenda for continued negotiations should prove a useful catalyst to multilateral negotiations. Only when they cease to serve that function can it be said that the FTA is undermining the multilateral order.

Conclusions

The Canada-United States Free Trade Agreement effects a fundamental change in Canadian trade policy and the management of Canadian trade relations with the United States. It provides a secure basis for far-reaching domestic economic reform and a bulwark against US protectionism. Consequently, the maintenance and development of the Free Trade Agreement will increasingly become the cornerstone of Canadian trade policy.

An important dimension of this is the ambitious continuing negotiating agenda. These negotiations are much more than just a question of subsidies, but also of customs matters, sectoral trade provisions, competition rules, government procurement, intellectual property and services. It would be a mistake to focus exclusively on subsidies and judge the long-term viability of the Agreement on the success of the subsidies negotiations. Indeed, the subsidies negotiations are the least likely to succeed, in part because the two governments may well conclude that a less ambitious result may prove politically wiser and satisfactory. More substantial results are likely in other areas, such as competition and intellectual property rules, and the success of these negotiations will reinforce the commitment of the two governments to cooperate and move away from unilateralism. Such success, in turn, will allow the two governments to strengthen the institutional and dispute settlement provisions of the agreement and through such provisions reduce the potential for conflict inherent in different approaches to subsidies in particular and the government/society relationship in general.

Three factors will influence the course of the continuing negotiating agenda called for under the FTA. In the first place, the anticipated economic benefits of the Agreement will have to materialize in order to provide both governments with the necessary business and political support to sustain these negotiations. Most of the issues under discussion are those that proved too difficult to resolve during the initial negotiations and thus will require substantial political will before they can be resolved. An increase of 2-3 per cent in GNP over 10 years, as suggested by econometric modeling, will not be sufficient to provide this momentum. Rather, a changed attitude on the part of Canadian entrepreneurs toward international business, leading to extensive restructuring and rationalization and a greater commitment to innovation and international marketing, will be required. The result should not be increased dependence on the US market, but a diversification in trading patterns as the Canadian economy strengthens and becomes more competitive on a worldwide basis.

Similarly, the long-term viability of the Agreement and continued success in resolving the remaining issues on the agenda will require a commitment by politicians and officials on both sides of the border to let the institutional and dispute resolution provisions of the agreement work. Nothing will corrode confidence in the Agreement more quickly than any suggestion that resort to a panel is a provocative act or that the need to use a panel procedure means that the Agreement is not working. Again, a new attitude in both capitals that considers bilateralism to be superior to unilateralism will need to be nurtured. Without such an attitude, there is little chance that the difficult issues left on the negotiating agenda can be approached creatively and successfully.

Finally, the long-term success of the FTA will require that it be seen as a complement and catalyst to multilateral negotiation and dispute resolution. Development of an attitude that the FTA is a substitute for and alternative to the GATT will also have a corrosive impact on the continuing agenda. It would foster a Fortress North America attitude and ultimately harm both the North American economy and the multilateral trading order.

Should these three attitudinal changes take hold in Canada and the United States, and there is reason to believe that they are already taking hold, there is every reason to be optimistic about the continuing negotiating agenda in general if not about the subsidies negotiations. In such a context, however, failure to achieve a subsidies code will not have great implications and will certainly not bring the continued viability of the Agreement into question. Indeed, there are good reasons to believe that less emphasis on the subsidies negotiations would be politically wise and lead to greater concentration on issues that are equally important and much more likely to lead to concrete and lasting results.

V.

The Link: Relationships Between the MTN and the Free Trade Agreement

The FTA and the GATT: The Link

Germain Denis

The link between the GATT and the Canada-US Free Trade Agreement (FTA) is not an obvious proposition to many observers. There is a perception by some that the GATT and the FTA are alternative trade policies for Canada. There is also a perception that the FTA and the GATT are mutually exclusive policy frameworks: one is bilateral and directed at the United States while the other is multilateral and covers the rest of the world. Few are fully aware of the intimate and complex relationships between these two major trade agreements.[1]

Part of this relationship is strategic in that both the FTA and the MTN are initiatives to resist protectionism, to strengthen the effectiveness and fairness of trade rules, and to promote trade liberalization. Another part is organic in that the FTA is itself an agreement within the framework of the GATT. Many articles of the FTA either incorporate, build upon, or seek to go beyond existing GATT provisions. Yet another part of this relationship is dynamic because it arises both from the unfinished FTA agenda and from the way that the FTA and the MTN will interact in terms of specific issues on both negotiating agendas.

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[1] The relationship between the FTA and the MTN was examined in some detail by Jeffrey J. Schott, "Implications for the Uruguay Round," followed by comments by John Whalley and Julius Katz in Jeffrey J. Schott and Murray G. Smith, eds., *The Canada-United States Free Trade Agreement: The Global Impact* (Ottawa and Washington: Institute for Research on Public Policy and Institute for International Economics, 1988). See also Frank Stone, "Relationship to GATT," in John Crispo, ed., *Free Trade: the real story* (Toronto: Gage, 1988) and William Diebold, Jr., "The New Bilateralism?" in William Diebold, Jr., ed., *Bilateralism, Multilateralism and Canada in US Trade Policy* (New York: Council on Foreign Relations, 1988).

The Strategic Link

A basic economic policy premise underlying both the FTA and the MTN is that the competitiveness of Canada's economy and Canada's long-term economic development will be advanced through trade liberalization. Indeed, as the FTA creates the basis for Canadian industries to become fully competitive on a North American basis, these industries will be in a better position to compete more effectively in global markets and to face offshore competition in their domestic market.

It has also been a key element of Canada's two-track trade policy of simultaneously negotiating a free trade agreement and participating in the current Uruguay Round negotiations to fight protectionist forces in the United States and other countries. Such protectionist pressures and uncertainties, coming from both inside and outside the United States, have made the status quo for an open economy such as Canada's an unrealistic and nonviable option. Efforts of the Canadian government in recent years have thus been to strengthen and improve the effectiveness and fairness of trade rules, both bilaterally and multilaterally.

The fact that both the MTN and the FTA were fully underway while the Omnibus Trade Bill was before the US Congress undoubtedly helped to moderate some of its most objectionable protectionist features. It provided evidence that the answers to some of the more difficult and controversial problems facing the United States and the international trade community in areas such as trade in services, agriculture, intellectual property, investment and unfair trade practices could be pursued in good faith at the negotiating table rather than imposed unilaterally through mandatory legislation.

The text of the overview of the FTA published in December 1987 stated that the FTA " ... sets a new standard for trade agreements concluded under the General Agreement on Tariffs and Trade (GATT)" reflects the commitment of both governments to liberalize trade on a global basis through multilateral trade negotiations under the GATT.

The preamble to the FTA also states that both Canada and the United States are resolved "TO BUILD on their mutual rights and obligations under the General Agreement on Tariffs and Trade (GATT) and other multilateral and bilateral instruments of cooperation; and TO CONTRIBUTE to the harmonious development and expansion of world trade and to provide a catalyst to broader international cooperation."

In addition, Article 101 of the FTA clearly states that the Agreement is consistent with Article XXIV of GATT, while Article 104 reaffirms existing GATT rights and obligations vis-à-vis the other Party to the FTA.

When Canada officially notified the GATT of the FTA in early 1989 in order to conform to the requirements of GATT Article XXIV, it stated that:

> The Canada-US Free Trade Agreement is among the most comprehensive of its type brought before the GATT and we are confident of its compatibility with the requirements of Article XXIV. ... This Agreement is a concrete manifestation of the commitment of both countries to general trade liberalization. ... The Agreement provides for rules in other areas, such as trade in services, which are also being addressed multilaterally here in the Uruguay Round.[2]

The GATT Working Party is not expected to complete its task before late 1989 or early 1990.

In his statement welcoming the GATT Trade Ministers in Montreal for the MTN Mid-Term Review in December 1988, Prime Minister Brian Mulroney highlighted the Canada-US Free Trade Agreement as a significant contribution to a policy of free trade. He stated:

> The Free Trade Agreement broke new ground in areas such as dispute settlement, investment and services, which may well serve as a model for the GATT. ... With Europe of 1992, the Canada-U.S.A. Free Trade Agreement, the Australia-New Zealand and closer ties in the Asia-Pacific region, world trade will either become more open or more restrictive. ... The stakes are too high, the benefits are too great to give in to protectionism.[3]

For a good part of GATT history, regional and multilateral trade initiatives have proceeded in parallel. The Dillon and Kennedy Rounds of the late 1950s and 1960s were largely initiated by the United States to ensure that the formation of the European Common Market would be accomplished by maintaining outward-looking policies that would not stand in the way of global reductions of tariff barriers. The Tokyo Round in the 1970s took place when the United Kingdom had just joined the EC, thus seeking to maintain outward-looking trade policies at least for nonagricultural products.

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[2] Statement by the Canadian Delegation to the GATT Council, 8 February 1989.

[3] *Address by the Right Honourable Brian Mulroney,* GATT Document MTN.TNC/MIN (88)/1 (5 December 1988), pp. 2 and 6.

Currently, there are various initiatives underway within the Asia Pacific region aimed at the possible creation of new trade and economic arrangements to encourage greater cooperation within the region. Whether these initiatives will lead to new regional arrangements remains difficult to predict. At this time, however, it is clear that the Asia Pacific region, including North America, has a great deal at stake in a modernized GATT as a central pillar of the multilateral trading system. There seems to be consensus that energies must continue to be concentrated on a successful outcome for the Uruguay Round.

The question of how regional and global trends can be managed in a way that expands trade opportunities and enhances the forces of fair international competition was captured in the statement by International Trade Minister John Crosbie at the recent Toronto Conference on Europe 1992. He said:

> I strongly hope that 1992, like our own Free Trade Agreement, will be a force for freer multilateral trade, with the rules extended on the basis of most-favoured-nation and national treatment. ... I have no doubt that protectionist forces will be at work. They must not prevail. ... Multilateral rules ... [are] the bridge between the three pillars of Asia, Europe and North America.[4]

The current Uruguay Round provides a framework and a catalyst to ensure that regional developments, including the completion of the European unified internal market by 1992, do not become inward-looking and protectionist to the detriment of international trade and of the open multilateral trading system.

This is reflected in Canada's objectives in the MTN which seek to expand access offshore for Canadian agriculture, resource-based products and a range of manufacturing and high-technology products and services. This is also an integral element of Canada's efforts to update, improve and expand multilateral trade rules in a number of non-tariff measure areas, particularly government procurement, technical barriers, import safeguards, subsidies and countervail and dispute settlement procedures. Additionally, this is a major motivation in developing new, mutually acceptable standards for the conduct and expansion of international trade in services as well as with respect to trade-related intellectual property and investment matters. In many of these areas featuring prominently on the MTN agenda, there is a close organic link with the FTA.

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[4] John Crosbie, Closing Remarks by the Minister for International Trade to the 1992 Conference, Toronto (10 April 1989).

The Organic Link

Beyond the general relationship between the FTA and the GATT created by the fact that the FTA technically constitutes an international agreement within the terms of Article XXIV of GATT, there are many FTA provisions which are either drawn directly out of the GATT, provide a bilateral interpretation of GATT provisions or build on such provisions. For example, within Chapters 3 to 13 concerning trade in goods:

- FTA Articles 407 and 409 (as well as 902 and 904 concerning energy products) reaffirm, clarify and interpret existing GATT rights and obligations with respect to import and export restrictions and prohibitions as these apply to Canada-US bilateral trade.

- FTA Article 602 reaffirms the rights and obligations of the FTA participants under the GATT Agreement on Technical Barriers to Trade reached during the Tokyo Round, particularly those provisions stating that technical regulations and standards, including packaging and labelling requirements and methods for certifying conformity, should not create unnecessary barriers to trade.

- FTA Article 710 reaffirms the existing rights and obligations under GATT Article XI which deals with supply management measures for agricultural products. Currently the United States has a GATT Panel proceeding underway against Canadian action on ice cream and yogurt under this GATT Article.

- FTA Articles 1301 through 1305 modestly broaden and deepen the obligations that both countries have undertaken in the GATT Agreement on Government Procurement reached during the Tokyo Round by lowering the threshold for the amount of procurement open to competition between Canadian and US suppliers in each other's market, and by improving transparency procedures for the bidding process.

- FTA provisions with respect to emergency safeguard actions are built on both a bilateral track (Article 1101) and a global track (Article 1102). The global track exempts each country from global actions under GATT Article XIX, except where the other producers are important contributors to the injury caused by a surge of imports from all countries, in which case its exports will be protected against reductions below the trend line of previous bilateral trade with allowance for growth.

- FTA Article 1201 incorporates the exception clauses of GATT Article XX, while Articles 2002 and 2003 cover GATT balance of payments and national security situations.

In the important public policy area of government subsidies and countervailing duties, while the FTA has established an innovative mandatory binational dispute settlement process to handle antidumping and countervailing duty cases after the final determinations are available, existing GATT rules and the national body of unfair trade remedy laws will continue to apply to bilateral trade between Canada and the United States until a new system is successfully negotiated. Indeed, one protection against unjustified recourse to countervail built into the FTA – Article 1902.2(d)(i) – is that amendments to national countervailing duty laws must be consistent with the GATT.

The Negotiating Link

There are a number of major issues on the MTN agenda which bear directly on Canada-US trade relations and the further negotiations called for under the FTA. Some of these issues were explicitly put on the MTN agenda by the two countries because they could not be resolved during the FTA negotiations (for example, procurement and intellectual property). In this regard, some useful homework in more fully understanding the issues was made in the FTA negotiations in preparation for the Uruguay Round. Some other MTN issues will impact upon the trade and investment environment within North America because of how the FTA and other regional arrangements, such as the EC as well as the negotiations with third countries in the Pacific and elsewhere, affect competitive conditions.

A central driving force behind both global and regional trade agreements has been the need to further improve conditions of access to principal expor markets. Although the reduction of traditional tariff barriers is relatively les critical today because tariff barriers are generally lower than they were in th immediate postwar era and because of concerns about non-tariff barriers an trade remedy measures affecting the predictability of market access conditions, the tariff continues to play a major role in trade negotiations both bilaterally and multilaterally. Canada has historically pressed the Europea Community, for example, to extend to Canadian exporters of resource-base products, such as fisheries, forest products and nonferrous metals, more equa competitive opportunities vis-à-vis Scandinavian suppliers who now benefi from preferential status with the Community.

Foreign suppliers will equally be interested in seeking, within th Uruguay Round, reductions in Canadian and American MFN tariffs in orde to restore competitive conditions that are more equal to those facing domestic suppliers within North America. Canada is in this bargaining position for the first time since it was able to bargain away Commonwealth preferential margins. In addition, rules of origin, which determine how various special tariff treatments other than MFN are to be applied, are receiving increasing attention on the MTN agenda.

Another important crosswalk between the FTA and the MTN is in the area of government procurement of goods and services. The objectives set out in the FTA in this respect were put in the context of "a further step toward multilateral liberalization and improvement of the GATT Agreement on Government Procurement" (Article 1301.2). Further bilateral negotiations will take place after the conclusion of the current multilateral negotiations (Article 1307). Moreover, Article 1301:1 stipulates that:

> In the interest of expanding mutually beneficial trade opportunities in government procurement based on the principles of non-discrimination and fair and open competition for the supply of goods and services, the Parties shall actively strive to achieve, as quickly as possible, the multilateral liberalization of international government procurement policies to provide balanced and equitable opportunities.

This crosswalk between bilateral and multilateral government procurement negotiations is likely to be intensified rather than reduced by the need to enlarge and deepen the scope and coverage of the GATT Procurement Code as the most effective way to ensure that Europe 1992 does not result in the imposition of discriminatory procurement practices vis-à-vis foreign-based suppliers of goods and services.

A multilateral negotiating framework for addressing subsidies and countervail issues as well as dispute settlement procedures in a balanced, comprehensive and integrated manner was agreed to at the Montreal Ministerial Mid-Term Review in December 1988.[5] This negotiation will likely proceed parallel to the FTA's bilateral five- to seven-year track.

The multilateral track will include the matter of appropriate disciplines on export and other trade-distorting subsidies (including agricultural products). Other major elements will cover the conditions and criteria under which foreign government subsidies could be legitimately actionable as unfair trade practices, whether on the domestic market (countervail), in the export market (import substitution) or in third-country markets (export displacement). These complex and difficult questions of how actionable subsidies should be defined, how the injury criteria should be applied and how investigation procedures should be handled will also be reviewed.

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[5] GATT Document MTN. TNC/7 (MIN) (9 December 1988), pp. 18-20.

The Montreal negotiating framework identifies as a major focus for the MTN the question of how to determine the conditions for the noncountervailability of such domestic programs as regional development, R&D and infrastructure. The issue of resource pricing has also been raised by some countries in the context of the Negotiating Group on Natural Resource-Based Products.

In addition, the MTN framework addressing subsidies and countervail issues will seek to strengthen multilateral dispute settlement procedures, thus reducing the scope for unilateralism in interpreting international rights and obligations. In this regard, I doubt that the FTA binational procedures in Chapter 19 could be a realistic model for the MTN because it is more akin to a domestic court system. The greater the disciplines on trade-distorting subsidies and the clearer the safe harbour rules for the noncountervailability of certain forms of subsidies, however, the more an independent and timely multilateral review process will need to be built into the new GATT rules.

Agricultural protectionism and trade-distorting subsidies around the world clearly constitute one of the most difficult and formidable challenges currently facing international trade policy and relations. Agricultural trade is plagued with extensive exceptions to existing trade rules and with a devastating subsidy competition between major agricultural producers and exporters. In the FTA, Canada and the United States agreed to consult more closely with each other and to take account of each other's export interests to avoid prejudicial effects when using export subsidies on sales to third markets. The FTA recognizes, however, that the problems of agricultural subsidies are global in scope and thus require global solutions in the GATT. Article 701 states that the "primary goal" of FTA participants with respect to agricultural subsidies is to deal with these issues in the MTN.

This may be achieved on the basis of the MTN negotiating framework agreed to in April 1989 with respect to agriculture.[6] This framework provides a substantial and progressive reduction of market-access barriers and of trade-distorting subsidies. It also provides for the development of new trade rules which should be equally applicable to all GATT members. This could mean that the US GATT Waiver, which was only slightly affected by the FTA, may finally be removed at the end of the Uruguay Round.

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[6] GATT Document MTN. TNC/7 (MIN) (9 December 1988), pp. 10-15.

With respect to trade-related intellectual property (TRIPs), Article 2004 of the FTA embodies a commitment to seek the development of multilateral solutions in the Uruguay Round. The strategic importance of state-of-the-art technologies for competitive purposes the increasing share of advanced technology embodied in goods and services crossing national borders as well as concerns over extensive counterfeiting practices will necessitate an effective set of international rules covering adequate standards, effective enforcement and multilateral dispute settlement. The negotiating framework on TRIPs agreed to at the MTN Mid-Term Review envisages a comprehensive and ambitious negotiation in the Uruguay Round.[7]

Any new GATT agreement on intellectual property matters will bear directly on the problems related to the manner in which section 337 is used by the United States to deal with cases of alleged infringement of patents. It will also necessarily affect those unilateralist features of section 301 of US trade legislation which currently substitute for a more orderly multilateral dispute resolution mechanism. These elements did not prove to be negotiable in the course of the FTA. Since then, however, the United States has been faced with a GATT panel report which found section 337 to be in violation of the GATT national treatment principle.

Conversely, the experience gained in the FTA negotiations in seeking to determine adequate intellectual property standards as well as to define reasonable provisions for their application and use, including compulsory licensing conditions and access to technology more generally, will be valuable in the TRIPs negotiations in the Uruguay Round. The FTA experience in terms of the approach used to potentially address the standards issue also shows that GATT involvement in TRIPs should not be sen by developing countries as a threat to the World Intellectual Property Organization (WIPO) and other international institutions dealing with intellectual property matters.

We are all familiar with the importance of the automotive industry in terms of Canada-US trade relations and of production and employment in Canada. It is also an integral element of the realities of international economic interdependence and of Canada's trade and investment relationship with a number of major offshore partners, particularly in the Pacific Rim. An FTA/MTN link has been created in Article 1004 of the Free Trade Agreement which establishes a Select Panel "...to assess the state of the North American industry and to propose public policy measures and private initiatives to improve its competitiveness in domestic and foreign markets." The United States and Canada also agreed to "...cooperate in the Uruguay Round of multilateral trade negotiations to create new export opportunities for North American automotive goods."

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[7] GATT Document MTN. TNC/7 (MIN) (9 December 1988), pp. 21-24.

Automotive market access issues relate not only to the treatment of MFN duties in the MTN but also to the outcome of what Europe 1992 will involve with respect to the treatment of offshore automobiles and parts in respect of rules of origin and of those special restraints imposed years ago by some European countries vis-à-vis Japan.

In the areas of investment and services, including financial services and business travel, the FTA went well beyond the GATT. The FTA, together with Europe 1992 and the expansion in 1988 of the Closer Economic Relations Agreement (CER) between Australia and New Zealand, are providing impetus to the MTN negotiations on trade in services. As a practical matter, the need to head off threats of narrow reciprocity requirements in the context of Europe 1992 will be a determining influence on the shape of an MTN deal on trade in services. Some authors, such as Jeffrey Schott, however, have described the FTA in these areas as path-breaking and serving as a model for future multilateral agreements.[8]

The FTA experience shows that services can be effectively brought within the scope of a comprehensive trade agreement. In my view, the precedent-setting nature of services does not arise from the market-opening nature of the FTA since the application of its basic rules and principles is prospective and relates to a positive list of services rather than being across the board. It comes rather from the useful conceptual and legal drafting and homework done on key concepts such as the application of national treatment to services trade and from the inclusion of services within the general dispute settlement procedures. The example set for dealing with rights of establishment and of commercial presence of service suppliers and with the temporary entry for services providers similarly provides a good beginning.

The sobering experience of the FTA in dealing with some particularly difficult sectoral issues in the services area could prove to be salutary for the MTN process. For example, the distinction introduced between access to the basic telecommunications networks and enhanced services will likely be useful for the MTN. On the other hand, the experience with shipping services may not auger well for the MTN. Although it is too early to say what an MTN deal on services may realistically cover, it is interesting to note that the

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[8] Jeffery J. Schott, "Implications for the Uruguay Round" in Jeffrey J. Schott and Murray G. Smith, eds., *The Canada-United States Free Trade Agreement: The Global Impact* (Ottawa and Washington: Institute for Research on Public Policy and Institute for International Economics, 1988), pp. 164-167.

Montreal negotiating framework envisages a comprehensive multilateral framework of rules to govern international trade in services, with no sector initially excluded from its potential coverage. It also incorporates possible rollbacks of specific impediments to services trade.

While the FTA rules with respect to investment (Chapter 16) have been widely perceived as setting a useful precedent for the Uruguay Round, it should be noted that the MTN deals only with Trade Related Investment Measures (TRIMs) as opposed to investment policies themselves. The FTA/MTN link is of the most direct significance with respect to Article 1603 of the FTA which prohibits the imposition of investment-related performance requirements such as local content, import substitution or export-targetting on investors, including those of a third country where such a requirement would have a significant impact on bilateral trade. Article 1610 of the FTA commits both Canada and the US to endeavour in the Uruguay Round to improve multilateral arrangements and agreements related to investment. Some of the relevant international instruments now existing are the OECD Codes on invisibles and capital movements.

Finally, reference should be made to the critical issue of dispute settlement. While the FTA was being negotiated, concurrent efforts to improve and streamline the GATT dispute settlement system were being made within the MTN. These efforts were partially brought to a successful conclusion at the 1988 Montreal Ministerial Meeting when agreement was reached on more automatic establishment of GATT panels, voluntary arbitration procedures and tighter time frames for the operation of panel proceedings (normally 6 months but no longer than 15 months from the beginning of bilateral consultations to the adoption of panel reports). The improvements introduced to the general dispute settlement process both bilaterally and multilaterally are therefore going in the same direction. The next steps in the Uruguay Round will have to address the difficult issues of adoption and implementation of panel reports, including those connected with unilateralism under US section 301.

Conclusions

The contemporary trade negotiations agenda reflects conflicting trends and the basic economic, technological, trade and investment developments that have shaped this decade and which are already influencing the next. The status quo does not exist with respect to the world trade system, whether developments occur on this continent, in Europe, in the Pacific or in other parts of the world. To ensure that the forces for a more open and predictable trading environment will be successful against protectionist threats, a stronger, revitalized and extended GATT is required.

It will be a difficult task to bring the Uruguay Round to a successful conclusion, but progress made with the completion of the Montreal Ministerial Review process is good evidence that the GATT is alive and ready to get stronger. The MTN is the bridge to ensure that all regional initiatives around the world – past, current, or potential – are mutually supportive in fostering open and more secure markets and sustainable growth world-wide.

Domestically, a common institutional link between the FTA and the GATT has been provided through consultations with the private sector (both the International Trade Advisory Committee and the Sectoral Advisory Groups on International Trade) as well as through arrangements for full participation by the provinces. These arrangements have ensured that Canada's overall objectives and priorities in the MTN and with respect to other trade policy developments such as FTA implementation have evolved in an integrated and coherent manner. A regular two-way flow of information and analysis between the federal government, the private sector and the provinces is part of this vital domestic component of Canada's overall trade negotiations management. While the experience in respect of provincial implementation of the relevant provisions of the FTA relative to the experience in respect of their response to GATT panel rulings constitutes another important link, any detailed discussion of this question is well beyond the scope of this paper.

VI.

The Uruguay Round: Prospects for Agreement

Uruguay Round Prospects for Agreement: Trade-Related Intellectual Property Issues

Judith H. Bello and Alan F. Holmer

Introduction

The agenda of the Uruguay Round multilateral trade negotiations is unquestionably the broadest and most ambitious of all the eight rounds of such negotiations. Negotiators aim not only to improve current but deficient GATT rules and disciplines, but also sweepingly to expand the frontiers of the GATT to cover "new" areas, including intellectual property (IP) protection, investment and services.

Of these new areas, none is more complex or controversial than the adequate and effective protection of intellectual property. Discussions to date reveal the conflicts in fundamental objectives of most developed countries and of many developing countries, making agreement elusive and differences hard to paper over.

This paper briefly reviews the state of the Uruguay Round trade-related intellectual property (TRIPs) negotiations, and outlines major IP issues that loom large in the interim, before the Round can reasonably be expected to conclude.

Trade Distortions Resulting from Inadequate or Ineffective IP Protection

TRIPs are an appropriate subject for GATT negotiations and GATT coverage because the absence of adequate rules and enforcement (as well as a reliable means for resolving IP disputes expeditiously and effectively) substantially distorts trade. IP deficiencies undermine the GATT objectives to expand world trade and reduce barriers to such trade. Specifically, tariff concessions are impaired when infringing goods replace legitimate, IP-protected exports in markets in which IP is not protected, and in third-country markets. Authors and inventors, for example, may prove unwilling to try to enter markets if their products are simply pirated or copied with impunity. The result is reduced trade in current and potential markets.

Moreover, the void that results from such disregard for or underdevelopment of potential markets induces IP infringers to fill it. This inducement may inappropriately allocate domestic resources to sectors lacking any comparative advantage – and therefore any long-term future in the global market.

Other trade-distorting results of inadequate IP protection include the short-term harm to consumers through customer deception when trademarks are infringed, and the loss of goodwill with respect to the trademarked product. They also include the long-term harm to consumers if the range and quality of available products decline as a result of insufficient incentive for necessary investment in research and development. If companies cannot recoup their often substantial costs in bringing innovative products to the marketplace, if authors cannot reap the anticipated benefits of their creativity, then innovation and creativity are discouraged – reducing consumer choices and curbing technological development, to the detriment of consumers worldwide. For example:

- Who will spend the millions of dollars necessary to develop new pharmaceutical products to fight new, often life-threatening diseases if drugs are pirated with impunity?

- Will the world's cultures be enriched as extensively if authors of its books, films and sound recordings cannot reasonably protect their creativity?

- By what other means can consumers be protected from disappointment in expectations stimulated by the trademark of a good and the quality it represents, but not sustained by a copied product?

Major Current Problems Regarding IP

Currently there are three major categories of problems with respect to IP rights protection.

Inadequate National Laws: First, many countries have either no or inadequate national laws in this area. Certain types of protection, such as an effective system for registering and recording rights in trademarks, are wholly nonexistent in some countries. More commonly, a country has laws affording some IP protection, but subject to woeful gaps.

With respect to patent protection, for example, many countries protect only process patents, not product patents. This shortcoming allows copiers to find an alternative process by which to manufacture precisely the same end product – depriving the inventor of the fair gains of his novel idea. Other countries have both process and product patent protection, but decline to afford it to certain sectors or products.–.such as pharmaceuticals or chemicals, foodstuffs, microorganisms, plant or animal varieties or nuclear-related inventions.

With respect to copyrights, for example, too many countries do not afford protection for sound recordings, cable retransmissions of copyrighted works or computer software. US software companies alone estimate that they lose hundreds of millions of dollars annually in a mere handful of markets because of piracy.

In addition to the absence of IP protection or its limited scope, a second major problem with some national laws is their abbreviated terms of protection. Even if laws for IP protection are sufficiently comprehensive in their reach, they must also provide an adequate period of time for an innovator to develop and test his product, initially market it and, most importantly, achieve an adequate return on his investment.

Third, some national laws misuse compulsory licensing programs. Subject only to any applicable restraints of national competition policy, inventors should have the freedom to choose whether to license the manufacture of their product, to whom and on what terms. Compulsory licensing programs unreasonably curtail these choices, and in extreme cases they can be confiscatory.

Ineffective Enforcement. Even to the extent that existing national laws for IP protection are adequate, they can nonetheless be woefully ineffective if they are not properly enforced. Here too deficiencies result in significant trade distortions, inconsistent with GATT objectives. Problems in the enforcement area include:

- failure to provide an opportunity for preliminary relief in meritorious circumstances

- lack of policy enforcement or border enforcement in appropriate circumstances
- the relative inaccessibility of judicial or administrative bodies dealing with IP issues
- onerous standards and burdens of proof that make it all but impossible – certainly most difficult – to successfully make a case that the law has been infringed (prime examples are the lack of a meaningful opportunity to obtain evidence through discovery, and in some countries the imposition of the burden of proof on the process patent owner alleging infringement of that process)
- insufficient penalties for violation of national IP laws, which thus fail to deter continued violations.

To be adequate and effective, national IP laws must be comprehensive in their scope and terms and reliably enforced.

Absence of any Dispute Settlement Mechanism: Of course, it makes little sense to negotiate GATT rules for adequate and effective IP protection unless disputes among governments about the application of those rules to particular facts can be expected to be resolved expeditiously and fairly. Just as the substantial improvement of GATT dispute settlement overall has been a major objective of the Uruguay Round, so the conclusion of any IP GATT agreement should include clear and well-considered procedures for resolving any disputes about the new rules.

TRIPs Negotiations to Redress These Inadequacies

The GATT currently includes provisions that recognize the legitimacy of national laws to protect intellectual property. For example, Article XX(d) provides a general exception to the GATT for the adoption and enforcement of measures "... necessary to secure compliance with laws or regulations which are not inconsistent with the provisions of this Agreement, including ... the protection of patents, trade marks, and copyrights, and the prevention of deceptive practices."

Articles XII:3(c)(iii) and XVIII:10 limit the measures that a Contracting Party may take in restricting imports for balance of payments reasons. Such restrictions may not be applied so as "... to prevent the importation of commercial samples or to prevent compliance with patent, trade mark, copyright or similar procedures." However, these articles by no means provide the GATT discipline that is needed to protect IP.

Progress to Date in the Uruguay Round Negotiations

At the launching of the Uruguay Round in Punta del Este in September 1986, a key US objective was to include intellectual property rights on the agenda for negotiations. A group of developing countries led principally by Brazil and India opposed this proposal since, in some cases, their national policies do not favour adequate and effective IP enforcement. In the final hours of those first negotiations, however, the ministers participating in Punta del Este agreed to include TRIPs on the agenda and established a negotiating group.

Some developing countries, however, continued to oppose the TRIPs objectives of the United States, shared at least in principle by most developed countries. Therefore, it came as no surprise that one of the toughest and thorniest negotiations in Montreal at the Midterm Review in December, 1988 was in the TRIPs negotiating group. Indeed, when ministers adjourned that meeting, consensus had been forged on texts for 11 of 15 framework agreements. The four which they were unable to resolve, however hard they bargained, included TRIPs (the others were agriculture, safeguards and textiles).

The Midterm Review was resumed the first week in April 1989 in negotiations attended by senior officials (not ministers) of GATT Contracting Parties. At last, consensus on framework texts was achieved in the four outstanding areas. For TRIPs, this outcome is significant because it removed the procedural impasse that had hindered that negotiating group. The resulting framework provides clear guidance that these negotiations shall include:

- adequate, substantive intellectual property standards
- effective means for enforcing such standards
- effective and expeditious resolution of disputes about the application of such standards.

The fact that consensus could be reached on these elements reflects that a significant number of GATT Contracting Parties now appreciate the importance of TRIPs negotiations and of the adequate and effective protection of intellectual property rights.

Interim IP Problems

However well and quickly the Uruguay Round TRIPs negotiations proceed, they surely will not be concluded before the end of 1990. A burning question in the international trade community is the extent to which (if any) it is appropriate for a government to take selective unilateral action in the interim aimed at achieving its objective of enhancing IP protection.

A case in point is Brazil's complaint about increased US tariffs on certain products of Brazil in response to Brazil's refusal to provide adequate product patent protection for pharmaceutical goods (an action taken under section 301 of the US Trade Act of 1974, as amended). Brazil argues that however inadequate the United States may consider its IP protection to be, selectively increasing US tariffs on products only of Brazil is inconsistent with US obligations under Article I of the GATT (to provide most-favoured-nation treatment), as well as Article II (not to raise tariffs beyond applicable bound rates). This debate is not without significant consequences in the international trade community, particularly at this important juncture of the Uruguay Round negotiations.

To stir this pot further, in 1988 the Congress passed new "Special 301" provisions that require the Office of the US Trade Representative (USTR) each year to identify: (l) those countries that fail to provide adequate and effective protection of IP rights; and (2) of those countries, those which are "priorities" for IP negotiations. By May 30 of 1989 and by April 30 in all following years, USTR must announce the countries selected for this honour and, within the following 30 days, self-initiate expedited investigations under section 302 of the Trade Act, as amended last year.

At the end of these necessarily brief negotiations, USTR is not required to take action (to retaliate through increased tariffs or quantitative restrictions), even if the negotiations fail and the country concerned continues to fail to provide adequate and effective IP protection. However, the political pressure on USTR to do so in such circumstances will be substantial. However judiciously USTR seeks to apply these special 301 provisions, some bilateral friction – with ripple effects for the Uruguay Round – will necessarily result.

Conclusion

Current trade law and policy developments regarding intellectual property protection reflect the trend for many other particular areas of trade: the growing tension between multilateral initiatives to establish fair, effective, and enforceable rules, and faster-moving bilateral initiatives spurred by the threat of selective unilateral action.

While this tension is by no means limited to the intellectual property sphere, it is perhaps at its strongest in view of the fundamental commitment of the US Administration to adequate, effective IP protection. If there is one issue that Republicans and Democrats, Northerners and Southerners and Westerners can all agree on in the United States, it is that America's comparative advantage lies principally in the high technology sector, which is dependent on strong IP protection for its profitability, innovation and global competitiveness.

The US national interest simply cannot afford to allow IP rights to be pirated with impunity while the Uruguay Round talks continue in Geneva and capitals around the world. Nor are domestic politics in the United States particularly patient for results that cannot be achieved before 1990. As a result, trade law and policy developments regarding IP protection are likely to provoke considerable debate and merit sharp focus within the international trade community over the next two years.

Services in the Uruguay Round: Key Policy and Negotiating Issues

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Murray G. Smith

Introduction

The proposal to negotiate trade in services created divisive debates in the GATT in the early 1980s. In particular, the developing countries expressed a variety of concerns about the proposed inclusion of services in the GATT. The real tensions in the trading system in the 1980s may have been, and may continue to be, among the United States, the European Community, Japan and developing countries over issues such as agricultural trade, managed trade in textiles and apparel and the proliferation of voluntary export restraints in industries such as steel and automobiles. But the existential debate over whether and how to negotiate services acquired great significance in the international trading system.

Quite apart from the *realpolitik* of trade relations in the 1980s, the proposal to negotiate trade in services raises sensitive issues about domestic policies and touches some of the most controversial nerves in international economic relations. The issue whether to negotiate services was resolved with the Punta del Este declaration launching the Uruguay Round which constituted a negotiating group on services; but the sensitivities raised must still be considered.

With respect to domestic policy issues, there are both economic and political concerns. The economic concern is that either the comparative advantage of developing countries may lie in an area other than services or the comparative advantage in services generally is more ephemeral than it is with respect to trade in goods and that developing countries may be giving up infant industry kinds of opportunities by entering into a services agreement. The political concerns pertain more to issues of perceived or actual threats to sovereignty, including constraints on domestic policy choices and erosion of political and cultural sovereignty.

The concerns expressed by developing countries in the GATT about services negotiations intruding on domestic policy resonate in Canada. Canada has gone through a very similar kind of debate about essentially the same set of issues, and Canadians expressed many similar concerns and sensitivities during the recent Canada-US negotiations. In the Canadian case, as in the more general multilateral case, the fact that the United States is proposing the negotiation of a services agreement is in itself grounds for suspicion, whatever the merits of the argument.

There are two international trade policy concerns which emerge from a Canadian perspective.[1] The first pertains to the management of trade relations in the multilateral system. Concern is often expressed that through either the negotiation or the operation of the unfair trade laws there will be threats of retaliation involving linkage between goods and services trade which might be to the disadvantage of Canada. The second trade policy concern is raised with respect to the negotiating agenda for the Uruguay Round itself. The question here is whether the negotiations of trade in services will divert attention from the real issues of interest to Canada, such as liberalizing agricultural trade and the dismantling of tariffs on natural resource products. It must be recognized, however, that although the United States and the European Community can agree on very little, they seem to be able to agree on their implicit common position that the Uruguay Round negotiations should focus on high technology and services issues.

Economic Policy Dimensions

Regarding the economic merits of the case for liberalizing trade in services, the concept of comparative advantage appears to apply to services, although we are obliged to think in a more creative, more careful and more general way about what we mean by comparative advantage. Of course, the economic logic of comparative advantage in the case of services may not necessarily be compelling in the policy-making process. Obviously, there are sectors producing goods, such as agriculture and apparel, where it is evident that comparative advantage lies elsewhere; but this outcome is resisted by trade policy.

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[1] See Rodney de C. Grey, "Services and Intellectual Property Rights," IRPP Discussion Paper in International Economics, Ottawa, 1988.

Perhaps most significantly from a policy perspective, comparative advantage in the services sector does not appear, at least on average, to be more or less ephemeral than a nation's comparative advantage for merchandise trade. Quite clearly, investment in human capital through public support of higher education will influence the competitiveness of the traded services sector in an enduring way. This observation is quite consistent, however, with the concept of comparative advantage. Unless the increase in investment in human capital is offset by increased emigration of the highly skilled, the nation's relative endowments, and hence its comparative advantages, are changing.

Framework policies which influence a nation's comparative advantage in goods production are also likely to influence a nation's comparative advantage in traded services. Indeed, traded services may respond to macroeconomic policies along similar lines to the manufacturing sector and in sharp contrast to the non-traded services sector. Review of proposals for strategic trade and industrial policies provides little or no rationale for restrictions on services trade; but the potential irreversibilities in developing specialized human capital and market niches indicate that unsustainable macroeconomic policies can have enduring consequences for services industries.

For example, a Reaganomics combination of expansionary fiscal policy and tight monetary policy will stimulate the consumption of non-traded goods and services, but will also produce an overvalued real exchange rate leading to gradual erosion of the real external balance on traded goods and services (exchange rate overvaluation refers to exchange rates resulting from unsustainable macroeconomic policies, and not from vagaries in financial markets). In the mid-1970s and again in the early 1980s, Canada had pursued this kind of unbalanced macroeconomic policy mix. Eventually, however, the accumulation of international liabilities imposes real exchange rate realignment to achieve the necessary adjustment in the external balance.[2]

The traded service sector may experience enduring consequences from a period of exchange rate overvaluation in a manner analogous to components of the goods producing sector. The nature of these consequences will depend upon the supply relationships and demand characteristics for the particular services industry and, in particular, whether the services firms can move easily from the traded services sector to the non-traded sector and then back to the traded sector. For example, restaurants in Montreal and Toronto may thrive during a period of exchange rate overvaluation by catering to local patrons, but they can easily serve hordes of tourists when local demand wanes and the exchange rate adjusts. Restaurants in Quebec City, Victoria or on the Cabot Trail may be much more dependent upon the tourist market. Thus, establishments may disappear during periods of exchange rate overvaluation and not re-emerge costlessly when exchange rate changes improve the competitiveness of tourism.

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[2] See Richard C. Lipsey and Murray G. Smith, *Global Imbalances and U.S. Policy Responses: A Canadian Perspective* (Toronto: C.D. Howe Institute, 1987).

Firms in the business and producer services sector may appear less sensitive to exchange rate fluctuations in the short term, but may suffer the most enduring consequences of persistent exchange rate misalignment. For example, engineering firms with specialized expertise and high export orientation may maintain overseas sales by virtue of their specialization when exchange rates are overvalued. Yet the loss of their international price competitiveness will lead to gradual erosion in international market share and make it more difficult to exploit emerging market opportunities. It will be more difficult for these firms to break into these specialized market niches when the exchange rate adjusts, because other firms from other countries will have developed expertise appropriate for these new market niches.

One cannot rule out the possibility that questions raised about the relevance of comparative advantage to trade in services were simply debating tactics to stall the negotiations. It is extraordinary, however, how examination of these questions by economists such as Bhagwati, Hindley and Smith, and Stern[3] has, at a minimum, been correlated with, and may have caused, a change in the posture of developing countries toward services negotiations.

If one uses net exports in traded services categories (excluding income on foreign investment) as a crude proxy for comparative advantage, then it is evident that some European countries have a greater relative comparative advantage in services than the United States. Developing countries are substantial net importers of "high-tech" services such as engineering consult-ing and insurance services, but are exporters of "low-tech" services such as shipping, construction and tourism. For example, remittances from citizens working abroad are a major source of export earnings for many developing countries.

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[3] Jagdish Bhagwati, "International Trade in Services and its Relevance for Economic Development," Xth Annual Geneva Lecture at the London School of Economics and the Graduate Institute of International Studies, 1985; Brian Hindley and Alasdair Smith, "Comparative Advantage and Trade in Services," *The World Economy*, vol. 7 (1984), pp. 369-390; and Robert M. Stern, "Global Dimensions and Determinants of International Trade and Investment in Services," in Robert M. Stern, ed., *Trade and Investment in Services: Canada/U.S. Perspectives* (Toronto: University of Toronto Press for the Ontario Economic Council, 1985).

Sovereignty Considerations

Sovereignty issues in framing a services agreement are potentially serious, but these concerns are shared by many countries. What emerged in the Canada-US Free Trade Agreement with respect to services and investment is a careful crafting of the policy obligations with respect to services – like the crafting of the national treatment obligations in the GATT itself – which are carefully balanced to protect the legitimate exercise of national sovereignty while limiting various kinds of discriminatory or protectionist practices by a commitment to national treatment with respect to new policies.

There is, however, a special case of particular interest to Canada and this involves concerns about the cultural industries. Particular kinds of support policies, if not import barriers or trade protection, are needed in order to maintain those sectors in the Canadian context. The broad exemption for cultural industries in the Canada-US Free Trade Agreement goes further than proposed by Card[4] and could be difficult to obtain in a multilateral forum.

More subtle questions involving the harmonization (or approximation) of regulatory policies are likely to arise in the context of sectoral negotiations in highly regulated industries. A commitment to national treatment and permitting right of establishment do not imply that regulatory systems must be made identical or compel deregulation, but such commitments could increase economic pressures for deregulation in some regulated industries. Furthermore, trade disputes are likely to continue to arise in services industries where there is substantial divergence among jurisdictions in regulatory policies.

Managing International Economic Relations

One might raise the question whether trade in services issues are as novel as the policy debate during the 1980s would suggest. In fact, the major industrial countries are signatories to bilateral Friendship Commerce and Navigation (FCN) treaties which impose national treatment obligations on international commerce encompassing some aspects of trade in services. Since these FCN treaties often have an MFN clause, these various bilateral treaties create a treaty system just as the bilateral MFN treaties, which various countries including Canada, concluded with the United States under the Reciprocal Trade Agreements Act of 1934, created a treaty system prior to the creation of the multilateral GATT framework.

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[4] Duncan Cornell Card, "Canada-United States Free Trade and Canadian Cultural Sovereignty," IRPP Discussion Paper in International Economics, December 1987.

There is, however, no general multilateral framework agreement governing trade in services and the provisions of the FCN treaties are very limited. In passing, it is noteworthy that if the Havana Charter for an International Trade Organization had been ratified, the ITO would have dealt with restrictive business practices as it applies to international services trade.

The question of managing trade relations and the procedures for resolving trade disputes are some of the more serious issues in the trading system today. The evolution of the institutional and dispute settlement procedures in the services negotiations and the proposed agreement is very important to the evaluation of Canadian interests in participation in the proposed GATT services agreement. It must be understood that Canada – except for issues which may be addressed under the general dispute settlement mechanism in Chapter 18 of the Canada-US Free Trade Agreement – confronts unilateralism with respect to services under US section 301 actions, and under the new commercial policy instrument of the European Community. Perhaps most alarming, the European Community is extending the application of its antidumping and countervailing duty laws to services.

The services issue illustrates the general proposition that the small or middle-sized economies have a strong stake in a rules-based system for dispute settlement. The services issue presents both a problem and an opportunity in that services lie outside the GATT. Therefore, the institutions and the dispute settlement mechanisms for services could be developed with a somewhat different architecture than we have in the GATT as a result of the agreement at the April 1989 meeting of the Trade Negotiating Committee, to implement the provisional agreement reached by Ministers at the Montreal Meeting in December 1988.

It is surprising that the Text on Services which was drafted at the Montreal Ministerial Meeting does not deal with dispute settlement. The issue of dispute settlement should be a central element in any services agreement and should not be left to the last minute to patch together provisions analogous to those under the various Tokyo Round Codes. It is possible to state a very simple bottom line. If a services agreement is going to serve the interests of smaller and middle-sized economies, then the agreement must have an effective multilateral dispute settlement mechanism which will restrain unilateral actions against unfair trade and services by the major blocs – the United States and the European Community. In particular, there should be no application of antidumping and countervailing duty laws to trade in services. The services provisions of the Canada-US FTA pass this test, but it remains to be seen whether the proposed GATT services agreement will meet this criteria.

Services in the Uruguay Round

Turning to the negotiating agenda in the Uruguay Round, a multilateral services agreement could be useful in two ways. First, a services agreement could help build domestic coalitions within the major trading powers – the United States, the European Community and Japan – which might support the overall GATT negotiations and facilitate the general strengthening of the trading system which is the stated goal of most of the players in the Uruguay Round. Second, liberalization of services could contribute to substantial negotiation in the Round on those specific issues of particular interest to Canada, including the resolution of agricultural trade problems, the reduction of tariff escalation which is impeding the further processing of natural resource products, the liberalization of tariff and non-tariff barriers to export of high technology products and the achievement of specific elements in the strengthening of the GATT system.

The Punta del Este declaration resolved the existential issue of whether to negotiate services within the GATT by creating a separate negotiating group on services which reports to the overall Trade Negotiations Committee for the Uruguay Round. Thus, negotiations on services are formally distinct from negotiations on goods. However, two points about the separation of the negotiations on goods and those on services must be kept in mind. First, all the major participants will evaluate the outcome of the Uruguay Round by considering what is achieved in all the negotiating groups. Thus, implicit cross-issue or cross-sectoral tradeoffs are to be expected. Second, in highly regulated industries with substantial state monopolies such as telecommunications, it is difficult to see how barriers in trade in services can be dealt with in total isolation from negotiations about barriers to merchandise trade.

Liberalization of Services Trade?

As Schott and Smith[5] observe, negotiations about trade in services may focus more on rule-making and less on liberalization of services trade. Negotiation of actual liberalization will require dealing with the various barriers to trade in services, including barriers to factor mobility.

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[5] Jeffrey J. Schott and Murray G. Smith, "Services and Investment" in Jeffrey J. Schott and Murray G. Smith, eds, *The Canada-United States Free Trade Agreement* (Washington and Halifax: Institute for Research on Public Policy and Institute for International Economics, 1988).

There are relatively few barriers to the international exchange of services among the industrial countries. Although there are examples of derogations from national treatment – some of which are sectoral, such as prohibitions on cabotage and some of Canada's cultural policies, and some which are horizontal, such as procurement preferences – most of the barriers in the industrial countries are barriers to investment or labour mobility.

The situation in the developing countries is more complicated. Derogations from national treatment on services transactions are more pervasive and often less transparent. Furthermore, the exchange rate controls and balance of payments difficulties of many developing countries create substantial barriers to international services transactions. In negotiating a framework agreement for services it would be important to avoid the kind of quantitative restrictions permitted for merchandise trade under Article XVIII of the GATT for balance of payments or developmental objectives. Needless to say, this proposal will be controversial with developing countries, particularly those developing countries who remain sceptical about the services negotiations.

The text of the Montreal Ministerial statement recognizes that the negotiations on trade in services must negotiate barriers to factor mobility. The developed countries focus on barriers to right of establishment and foreign direct investment, while the developing countries are concerned about barriers to labour mobility. It is noteworthy that the Canada-US Free Trade Agreement dealt with labour mobility in a narrow way by expediting temporary entry for business people and professionals. Even between two high-wage economies, it was not possible to liberalize the movement of blue collar workers in industries such as construction or to remove barriers to trade in transportation services. Thus, the scope for significant liberalization of factor flows (even on a temporary basis) between developed and developing countries appears limited, at least initially, in a multilateral framework agreement on services.

Canada's Interests

Subject to the specific provisions of the arrangements which might be negotiated on services in the Uruguay Round, it appears to be in Canada's interests to broaden the number of countries with which Canada has contractual obligations with respect to controls on trade in services and related investment issues. The gains from trade theorems appear to be particularly robust for trade in producer services and this is the category of international services trade which is the most dynamic. Under certain circumstances there may be a case for infant-industry support, but the case for infant-industry protection is much weaker.

It must be observed that much of services trade, particularly involving producer services, occurs on an intracorporate basis. If both input and output markets within which firms are operating are relatively competitive, then overall trade patterns will be influenced by the underlying comparative advantage regardless of whether the international transactions occur in open markets or within corporate conduits. There are reasons to doubt that multinational enterprises operate in perfectly competitive markets, but simultaneous liberalization of merchandise and services trade is likely to increase the degree of competition facing multinational enterprises in the various markets within which they are operating.

It must also be noted that the stock of Canadian foreign direct investment has risen substantially over the last 15 years, while foreign investment in Canada has grown slowly. Thus, even if services trade follows the corporate logo, then the export opportunities for competitive Canadian services are likely to expand.

Several caveats to the general proposition that it is in Canada's interest to participate in a multilateral services agreement should be kept in mind. First, it would be important to extend the exclusion of cultural industries which was obtained in the Canada-US Free Trade Agreement to any multilateral arrangement. Failure to exclude the cultural industries in the multilateral services agreement could make participation unattractive to many Canadians.

Second, it may be difficult to balance the rights and obligations of a large number of countries under a general services agreement of the sort proposed by the United States which would be focused upon a commitment to national treatment and provide market access. Instead, the general services agreement might be better limited to a commitment to national treatment with explicit negotiations of covered services where right of establishment is uncontroversial among the participants. Specific sectoral agreements may well be necessary to give effect to the overall framework agreement in order to deal with subtle barriers to trade and investment arising from national regulatory policies in service industries which are highly regulated or where some countries are reluctant to permit right of establishment.

Third, it is important to avoid a supranational mechanism supervising national regulatory policies which could impose additional delays on decision making as well as raising concerns about national sovereignty. Divergence in national regulatory policies should be permitted subject to the agreed commitments to national treatment and market access contained in the services arrangements.

Fourth, the Uruguay Round negotiations on services have not yet focused on the specific form of the dispute settlement mechanisms which might be adopted as part of a new services agreement under the GATT framework. Whatever the substantive provisions of new arrangements for trade in services, it is in Canada's interest to adopt a dispute settlement mechanism for services analogous to that in the general dispute settlement mechanism (Chapter 18) in the Canada-US Free Trade Agreement, in order to avoid potential unilateral measures directed against Canadian service industries or government policies on the basis of allegations of unfair trade practices.

In an increasingly interdependent world, barriers to trade in services can be barriers to trade in goods and vice versa. Canadian industries might benefit from a multilateral services agreement as exporters of services, as importers of services, as exporters of goods and as producers of complex bundles of goods and services. Services issues are almost unavoidable in a global economy governed by nation states, but the litmus test for Canada is whether a multilateral services agreement does in fact create a more transparent, a more open and a more predictable international regime for services transactions.

GATT Dispute Settlement: The 1988 Montreal Reforms

William J. Davey[*]

This paper will discuss certain aspects of the ongoing Uruguay Round of trade negotiations, which are being conducted under the auspices of the General Agreement on Tariffs and Trade (GATT). It will focus on that part of the negotiations that are concerned with improving the GATT dispute settlement system. In particular, it will consider the reforms adopted at the 1988 Montreal midterm review of the Uruguay Round.

Introduction

The General Agreement has served as the principal instrument under which most of the world's trade has been conducted since its inception in 1948.[1] It lays down detailed rules that, *inter alia*, restrict the ability of its Contracting Parties to raise their tariffs, to impose quotas or other import restrictions, to discriminate among or against their trading partners who are also GATT members, or to subsidize their exports. Needless to say, the GATT rules are not always obeyed. Consequently, the GATT faces the difficult problem frequently encountered by international organizations: how can a treaty-based organization interpret and enforce its rules when its members are sovereign nations?

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[*] I would like to thank Ernst-Ulrich Petersmann for helpful comments on an earlier draft of this paper. The views expressed herein are, of course, my own.

[1] The most comprehensive analytical treatment of the General Agreement is John H. Jackson, *World Trade and the Law of the GATT* (Indianapolis: Bobbs-Merrrill, 1969). See also Edmond McGovern, *International Trade Regulation*, 2d ed., (Exeter: Globefield Press, 1986).

The problem of implementing an effective dispute settlement system in the GATT is complicated by the fact that the General Agreement (l) was intended to be subsumed under the International Trade Organization (ITO), an entity that was stillborn because of US congressional opposition; and (2) was, in any event, only brought into force provisionally in 1948. Although the GATT's 40-odd year existence has largely made its provisional status irrelevant today, the lack of the organizational structure that would have been supplied by the ITO has been a more serious drawback. It has forced GATT members to create an organization under an agreement that tried to avoid any organizational structure beyond giving broad powers to its Contracting Parties, acting jointly. As discussed below this has had unfortunate ramifications for the GATT dispute settlement system, as well as the functioning of the GATT system generally.

The Current GATT Dispute Settlement System and its Problems [2]

The basic dispute settlement provision of the General Agreement is Article XXIII, which may be invoked by a GATT member if it considers that "any benefit accruing to it directly or indirectly under this Agreement is being nullified or impaired ... as the result of (a) the failure of another contracting party to carry out its obligations under [the] Agreement ...." A complaining Party is required first to raise its complaint with the alleged offender, which is required to give sympathetic consideration to the complaint. If no "satisfactory adjustment" is reached within a "reasonable time," the matter may be referred to the Contracting Parties acting jointly, who are promptly to investigate the matter and make "appropriate" recommendations or rulings. If the circumstances are serious enough, the Contracting Parties acting jointly may authorize the injured country to retaliate by suspending some of the trade concessions it has made to the offending country.[3]

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[2] For a recent description of how the GATT dispute settlement system works, see Davey, "Dispute Settlement in GATT," *Fordham Journal of International Law*, vol. 11 (1987), at p. 51. Professor Hudec is probably the leading authority on GATT dispute settlement. See Robert E. Hudec, *The GATT Legal System and World Trade Diplomacy* (New York: Praeger, 1975); Adjudication *of International Trade Disputes* (London, Trade Policy Research Centre, 1978); "GATT Dispute Settlement After the Tokyo Round: An Unfinished Business," *Cornell International Law Journal*, vol. 13 (1980), at p. 145; "Reforming GATT Adjudication Procedures: The Lessons of the DISC Case," *Minnesota Law Review*, vol. 72 (1988), at p. 1443; and "Legal Issues in US-EC Trade Policy: GATT Litigation 1960-1985" in R. Baldwin et. al., *Issues in US-EC Trade Relations* (1988).

This bare-bones provision has required amplification over the years in order to make it workable, in particular because the Contracting Parties acting jointly in general assembly (there are almost 100 now) are not at all well suited to act as a judicial body to consider disputes. Thus, from the beginning, smaller groups have been delegated much of the dispute settlement function of the Contracting Parties.

Under the procedures in effect at the commencement of the Uruguay Round, disputes in the GATT were handled as follows:[4] After bilateral talks between the contending Parties had failed to resolve a dispute, the injured Party would bring the matter to the attention of the GATT Council (a body to which the Contracting Parties acting jointly have delegated almost all of their powers and in which some 70 of the GATT's members participate) and request the appointment of a panel of individuals to consider its complaint. Those individuals would act as individuals and not as representatives of their respective countries.[5] The panel would hear the arguments of the Parties and prepare a decision, often with the assistance of the legal staff of the GATT Secretariat. The panel decision would then be submitted to the GATT Council, where it would usually be adopted on behalf of the Contracting Parties.

Over the years, there have been many complaints about the operation of the GATT dispute settlement system, and it is useful at this juncture to consider the major ones before considering the reforms adopted at the Montreal midterm review of the Uruguay Round. One major disagreement with respect to the dispute settlement system in the GATT has been a philosophical one: should the dispute settlement system provide a rule-oriented, judicial approach or a negotiation, consensus approach to dispute settlement. Essentially, this controversy boils down to the questions of (l) how ironclad are the commitments that the Contracting Parties made in the General Agreement; and (2) assuming that there are some clear commitments, how can the GATT best enforce those commitments in a way that furthers the overall goals of the organization.

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[3] Dispute settlement under the Tokyo Round Codes is generally modelled on GATT Article XXIII. The discussion in this paper is therefore applicable to dispute settlement under those codes. Where there is a significant difference between Article XXIII and a code provision, this is noted in the text.

[4] See the 1979 Tokyo Round Understanding Regarding Notification, Consultation, Dispute Settlement and Surveillance, in GATT, *Basic Instruments and Selected Documents* (BISD), vol. 26 (1980), pp. 210-218; the 1982 Ministerial Declaration on Dispute Settlement Procedures, in GATT, BISD, vol. 29 (1983), pp. 13-16; and the 1984 Decision on Dispute Settlement Procedures, in GATT, BISD, vol. 31 (1985), pp. 9-10.

[5] Until recently, however, almost all panelists were governmental trade experts, frequently representing their countries at the GATT in Geneva. Nowadays, the use of nongovernmental panelists has become more common.

I think that it is now generally agreed that GATT members do undertake serious commitments and that, if they violate those commitments, they understand that they may be called to task before the GATT dispute settlement procedure. Nonetheless, there are two caveats that should be noted here. First, because of the provisional nature of the GATT, there are some Parties that still seem to be uneasy over the notion that they can be called to account for violating a provision of the General Agreement. They seem to prefer to think of the General Agreement as an agreement under which they have committed only to negotiate the solution of trade problems with other GATT members in good faith, rather than one under which they have made enforceable substantive commitments. Generally, I think that this notion in its strongest form, that there were no commitments made beyond one to negotiate, is no longer believed. But it is also necessary to consider a second caveat, namely, that there are some provisions of the General Agreement which many Parties believe should not be strictly enforced because they believe that the lax enforcement of the past has essentially changed the commitment from what was written in the General Agreement to some other, less rigorous one. This view has been expressed particularly in the case of trade in agricultural products with respect to the use of quotas to protect internal markets and the use of subsidies to promote exports. Generally, however, GATT dispute settlement panels have strictly interpreted the General Agreement.[6] Consequently, this line of argumentation is taken less seriously today.

As to the question of how the GATT can best enforce the commitments that do exist, there is some disagreement over whether an adjudication or negotiation approach is more desirable and which approach will ultimately be more successful. Those who support a negotiation approach argue that a judicial approach may poison the atmosphere by designating winners and losers which, in the case of sovereign states, may make the eventual resolution of conflict more difficult. They also worry that a more judicial approach will occasionally lead to bad decisions and encourage the filing of complaints in cases ill-suited for consideration in the dispute settlement system (e.g., cases involving imprecise GATT rules). Others reply that a negotiation approach promotes the watering down of commitments, in part based on the respective political power of the disputants, and does little to promote strict compliance with GATT rules, which ought to be the goal of the GATT dispute settlement system.[7] In recent years, the upper hand seems to have been taken by those who support a more adjudicative model, although reform efforts designed to make this model ever more predominant always run into opposition from those who oppose that model generally.

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[6] See, e.g., EEC–Quantitative Restrictions Against Imports of Certain Products from Hong Kong, GATT, BISD, vol. 30 (1984), pp. 138-139; Japan–Restriction on Imports of Certain Agricultural Products, GATT Document L/6253 (18 November 1988). Dispute settlement panels operating under the so-called Subsidies Code are a major exception to this statement.

In addition to this philosophical debate, there have been four major criticisms leveled at the operation of the GATT dispute settlement system in recent years. The first is the problem of delay, which arises at all stages of the proceedings: from the decision to establish a panel; to panel member selection; to panel consideration of the issues; to adoption of the panel report; and to implementation of the report. The second problem concerns the procedures for adopting panel reports, and more specifically whether the Contracting Parties involved in the dispute should be able to veto adoption of the report by the Council. This has occurred occasionally. The third criticism is that adopted panel decisions are not always fully implemented, so that the rights of the prevailing Party are not vindicated. Finally, there have been criticisms aimed at a number of procedural problems in the panel process, raising, for example, such questions as how panelists should be selected, how the interests of third parties should be protected and how dispute settlement under the Tokyo Round codes relates to dispute settlement under Article XXIII.[8]

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[7] For a more detailed examination of this philosophical dispute, see Davey, "Dispute Settlement in GATT," *Fordham Journal of International Law,* vol. 11 (1987), at pp. 65-81.

[8] For general discussions of reforming the GATT dispute settlement system, see Davey, "Dispute Settlement in GATT," *Fordham Journal of International Law,* vol. 11 (1987), at pp. 90-108; E.-U Petersmann, "Proposals for Improvement in the GATT Dispute Settlement System: A Survey of Comparative Analysis" in D. Dicke and E.-U. Petersmann, eds, *Foreign Trade in the Present and a New International Economic Order* (1988), at p. 340. Mr. Petersmann is a Counsellor in the Legal Office of the GATT Secretariat and acts as secretary to the GATT negotiating group on dispute settlement. See also M. Hilf, "Settlement of Disputes in International Organizations: Comparative Analysis and Proposals for Strengthening the GATT Dispute Settlement System" at p. 285; E.-U. Petersmann, "Strengthening the GATT Dispute Settlement System: On the Use of Arbitration in GATT" at p. 323; Bradley, "Implementing the Results of GATT Panel Proceedings" at p. 345 in E.-U. Petersmann and M. Hilf, eds, *The New GATT Round of Multilateral Trade Negotiations: Legal and Economic Problems* (1988); and John Jackson, "Governmental Disputes in International Trade Relations: A Proposal in the Context of GATT, *Journal of World Trade Law,* vol. 13 (1979), at p. 1.

The Uruguay Round Midterm Reforms: An Evaluation

At the December 1988 Montreal midterm review session, at which the Contracting Parties reviewed the progress made to date in the Uruguay Round negotiations and adopted negotiating frameworks for the next two years of talks, agreement was reached on reforms of the GATT dispute settlement system that will be used on a temporary basis until the conclusion of the Uruguay Round.[9] Presumably if the reforms work, they will then be permanently adopted. It is instructional, therefore, to consider the extent to which the reforms do and do not address the problems cited above.

Adjudication or Negotiation

Philosophically, the Uruguay Round reforms continue the trend toward making the GATT dispute settlement system more adjudicative in nature. This is true particularly because the time set aside in the system for discussions and negotiations has been sharply circumscribed. Under the reforms, a panel can be requested only 60 days after the initial request for consultations has been made under Article XXIII:1, and the panel is normally to be established by the Council 45 days or so thereafter.[10] Formerly, the consultation phase of disputes often dragged on for a longer period. In addition, the procedures adopted to handle multiparty complaints and intervention by third parties are quite reminiscent of civil court procedures. As will be discussed below, however, certain proposals designed to make the GATT dispute settlement system even more adjudicative in nature were not adopted.

Delays

One of the principal themes of the reforms is to establish deadlines for the accomplishment of various steps in the dispute settlement process. Under the reforms, a Contracting Party who is requested to consult with another Party about a mutual trade problem is required to enter into consultations in good faith within 30 days of the request for consultations. If the consultations fail to settle a dispute within 60 days of the request for consultations, then the complaining Party has the right to ask that a panel be established to consider the dispute. As noted above, there is at present no time limit on consultations and it is common for consultations to drag on for longer than the 30 to 60 days envisaged by this reform.

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[9] The reforms are contained in GATT Document MTN. TNC/7 (MIN), at pp. 26-33 (December 9, 1988). The reforms came into effect in April, 1989, following the delayed completion of the midterm review. See New York *Times*, April 13, 1989, at. p. 32.

[10] Even shorter time periods are adopted for disputes involving perishable products.

In the past, GATT members have not had the right to have a panel established to hear a complaint under Article XXIII. The decision whether to appoint a panel was viewed as being within the discretion of the Council. Although a persistent complainant has always been able to get a panel established, there was no time within which the Council was expected to act. Under the Uruguay Round reforms, the complaining Party has a right to request that the panel be established at the second Council meeting at which the request appears on the agenda, or within 60 days or so at the maximum since the Council normally meets every month. Although the complaining Party has a right to make this request, the reforms explicitly give the Council the right to "decide otherwise," i.e., to postpone the establishment of the panel, and nothing is explicitly said with respect to the "right" of a Party to have a panel established, although the detailed time limits suggest that the establishment of a panel ought to take place. Thus, this reform is rather nuanced and may or may not ultimately speed up the establishment process.

The establishment of panels has sometimes been delayed by disputes over the terms of reference or instructions to be given to the panel. The reforms provide that so-called standard terms of reference will be used unless the Parties agree to the contrary within 20 days of the establishment of the panel.

Delays have also resulted from disputes over who should serve as panelists. The reforms address this problem in two ways. First, it is agreed that the roster of nongovernmental experts should be expanded, which eases the problem of relying too heavily on the use of knowledgeable governmental panelists from neutral countries, who are by definition in short supply. Second, it is agreed that the Director General may form the panel, in consultation with the Chairman of the Council and the contending Parties, if the Parties cannot do so within 20 days of the decision to establish a panel. The Director General is to do so within 10 days.

The reforms also provide that normally the panel should report within six months of its establishment. If this is not accomplished, the panel is to report to the Council and, in any event, finish its work within nine months. When completed, the panel report may be considered by the Council 30 days after it has been circulated to the Contracting Parties. Those Parties having objections to the report are to submit them in writing at least 10 days prior to the Council meeting. The reforms also provide that, unless agreed to by the Parties, the entire process from the request for a panel to adoption of the report shall not exceed 15 months. Consequently, no more than three months or so should elapse during Council review of the report.

All in all, it can be said that the reforms do as much as can be done by rule to speed up the panel process. By establishing these time limits, they suggest what ought to occur and will give complaining Parties a useful foundation upon which to base their complaints that the process should move at that speed. The time limits may not be effective unless there is a willingness on the part of the GATT Secretariat to press for their observance and a willingness on the part of the concerned Parties to observe them. Recent experience suggests, however, that the reform's time limits may well be met. In the last few years, and despite an increase in the number of panels at work, most disputes have been processed within the new overall time limits.[11] Thus, these "reforms" may largely just codify current practice, except to the extent that they attempt to shorten the preliminary phase of the process. Unfortunately, this attempt to shorten the preliminary phase, particularly with reference to panel establishment and selection, may not produce notably different results than the present procedures.

Automaticity of Panel Establishment: With respect to the decision to establish a panel, it is not completely clear what happens under the reforms if, at its second meeting, the Council does not act to establish a panel. The new rules state that "a decision to establish a panel shall be taken ... unless at that meeting the Council decides otherwise." It can be argued that this wording means that the Council must establish a panel unless there is a consensus not to establish a panel, which would mean that a complainant would have to consent to any delay. This interpretation of the new rules is apparently what was intended by the negotiating group, although it is conceivable that some Contracting Parties will argue that, since the decision to establish a panel still requires affirmative Council action under the reforms and since traditionally the Council acts only by consensus, a failure by the Council to act on a request should be treated as a decision not to establish a panel.

This procedural change raises the question whether more automaticity should be incorporated into the GATT dispute settlement system. To answer this question, it is necessary to consider dispute settlement under the 1979 Subsidies Code, which provides for the automatic establishment of a dispute settlement panel on request of one of the Parties. One can argue that the abject failure of dispute settlement under that Agreement is due to the fact that the Code signatories cannot winnow out inappropriate cases before referring them to panels. I would argue, however, that the failures of dispute settlement under the Subsidies Code are due principally to the failure of the panel to make a decision in the first case brought thereunder, which was a US complaint about EC wheat flour export subsidies. Although the panel may have been correct to believe that it was difficult or impossible to figure out what the exact EC share of the world flour market would have been in the absence of export subsidies, it is beyond question that the existing EC share was far in excess of whatever the appropriate share was. Had the panel followed the approach taken in cases involving Article XI, for example, by putting the burden on the EC to establish that its share was not more than its equitable share as required by the Subsidies Code, the case could have been easily disposed of. True, the result would have been controversial in the sense that the EC would have been very annoyed; but there was an existing GATT precedent dealing with French wheat and flour exports under a system similar to the EC system wherein a panel concluded that there was a violation of Article XVI, the terms of which, if anything, are less strict than those of the Subsidies Code. While the EC is very sensitive to what it perceives as attacks on its Common Agricultural Policy, this case did not involve the heart of that policy, which is to support the income of EC farmers. The case involved only the question of who would pay to do that – the EC or other wheat-exporting countries. The protected internal EC market was not affected.

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[11] E.-U. Petersmann, "Strengthening the GATT Dispute Settlement System: On the Use of Arbitration in GATT" in E.-U. Petersmann and M. Hilf, eds, *The New GATT Round of Multilateral Trade Negotiations: Legal and Economic Problems* (1988), pp. 334-335.

Had the panel in the wheat flour case been more responsible, it is possible that dispute settlement under the Subsidies Code would be viewed as a success. Admittedly, the second case, which involved an adverse decision on EC pasta export refunds, was controversial. The EC felt that a new obligation had been created, although it appears that the EC simply failed to reserve its rights as others had done in the past. In any event, without the precedent of the United States and others blocking adoption of the panel report in the wheat flour case, the EC would have found it more difficult to block adoption of the pasta decision. Moreover, the pasta issue was probably not all that important, as the United States and the EC ultimately negotiated a settlement.

All of this suggests that a more automatic system should not be feared because of the Subsidies Code experience. Moreover, since panels are virtually always appointed, recognition of a right to have a panel appointed would seem to be appropriate.[12]

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[12] Some commentators have worried that such a right would lead to "wrong cases" being brought. I have argued elsewhere that this fear is exaggerated. Davey, "Dispute Settlement in GATT," *Fordham Journal of International Law*, vol. 11 (1987), at pp. 73-76. Recent history supports my view. Article XI's ban on quotas has not been strictly complied with in the past. Consequently, cases asking for strict enforcement of Article XI would have been characterized as wrong cases in the not too distant past, yet several recent decisions seem to have established that Article XI cases can be handled successfully. Even where cases have not been brought (e.g., Japan's complaints about EC member state

Panel Composition: In the case of the rules on composition of panels, the reforms give considerable power to the GATT Director General to speed that process. A similar approach to deadlock over panel composition (with looser time limits) was adopted in 1984, but the Director General did not use his power to staff panels, apparently because no one ever requested him to do so. This past experience makes it unclear whether he will do so under the reforms if the required consultations with the Parties are negative. Thus, it may well be that delay will continue to occur in this part of the process as well.

Panel Procedures: In the panel process itself, there are more detailed procedures laid down with respect to submissions by the Parties, but there is no enforcement mechanism that would allow the panel to sanction a Party for not complying with the deadlines. Of course, the panel could decide the case based on the best information available, or the complainant could initiate a new action perhaps claiming a breach of the reformed rules; but neither of these courses of action is likely, especially since they would make the panel decision more easily attackable in the Council when it came up for adoption.

All in all, it seems that the reforms will reduce delays in the GATT dispute settlement process, albeit probably only to a minor degree in most cases.

Veto of Panel Report Adoption

The second major operational criticism of the GATT dispute settlement system concerned the procedure by which panel reports are adopted by the Council. Under the reforms, all Parties continue to have a right to participate in that decision, including those directly involved in the dispute. According to the reforms, however, "the delaying of the dispute settlement process shall be avoided" – a slight variation on the 1982 requirement that Parties avoid "obstructing" the process. In addition, the reforms provide that a decision whether to adopt the panel report shall be taken within 15 months of the request for consultations. Absent the consent of all Parties, however, that decision will be negative under current procedures. Thus, more must be done to improve this aspect of the GATT dispute settlement process.

Implementation

With respect to the third major operational criticism of the system, which concerned implementation of panel decisions, the reforms establish a more formal reporting system in which the offending Party is asked to report regu-

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quotas), negotiations have been proceeding on the assumption that Article XI must ultimately be complied with.

larly on the status of implementation of the panel decision. As will be discussed below, much more must be done to improve implementation of panel decisions.

Procedures

Finally, in response to complaints about inadequate procedures, the reforms provide a mechanism for handling multiparty complaints. Generally, the use of one panel is to be favoured. They also formally provide for the right of interested third parties to make submissions to the panel.

The Unfinished Business of the Uruguay Round Negotiations on Dispute Settlement

The Uruguay Round midterm reforms address two problems faced by the GATT dispute settlement system: the problem of delays and the problem of a lack of procedures for multiparty proceedings. They do not address the two other significant problems noted above: the traditional ability of a contending Party to veto an adverse panel decision and thereby consign it to limbo, and the problem of ensuring implementation of panel decisions. In addition, the reforms scarcely consider one frequently mentioned method of improving GATT dispute settlement: formalizing an arbitration process under the GATT's auspices, available at least to those Parties who wish to avail themselves of it. Nor do they consider, from a long-term perspective, what sort of dispute settlement system the GATT ought to be moving toward or how to coordinate the various dispute settlement procedures now found in the GATT system.

Consequently, while the reforms are good as far as they go, there is a real question whether they go anywhere near far enough if the GATT dispute settlement system is to be effective in the coming years. If the GATT dispute settlement system is to live up to the expectations that many people have for it, the problems associated with the nonbinding nature and nonimplementation of panel decisions must be addressed.

The Continuing Need for a Binding Dispute Settlement System

The present dispute settlement system does not produce binding decisions because the panel report can be vetoed by the losing Party, or by any other GATT member, since by tradition the Council acts only by consensus. Although this has not happened often, it has from time to time, and it seems to be happening with increasing frequency.[13] Moreover, even in cases where a panel report has been adopted, the losing Party and other GATT members have on occasion expressed their disagreement with the decision and claimed that it did not represent a precedent for future dispute settlement panel decisions. It can be argued that this problem of blockage is not serious, that it represents only the last gasp of a losing Party trying to retain some dignity before it ultimately negotiates a settlement with the prevailing Party, and that the value of Council review of panel decisions as a filtering device offsets any drawbacks.[14]

I argue below that there are better ways to accomplish the filtering process and I would contend that blockage is a serious problem. First, it unfairly tilts the balance of power toward the loser, who must be persuaded to agree to lose and then to agree to comply with the panel decision. At each stage, the panel decision is likely to be compromised. This is inappropriate since a dispute settlement system ought to favour the winner and promote compliance with the agreed-upon rules. Second, when reports are not adopted or when some nations consent to their adoption but claim they are not precedents, the clarity of the GATT rules is undermined, which reflects adversely on the GATT dispute settlement system. As use of the system increases, which seems to be happening, this confusion over the status of nonadopted or questioned cases will increase. This problem will worsen significantly as smaller Contracting Parties become more involved in the dispute settlement process and exercise their veto "right." It is one thing to argue that a major power (e.g., the United States, the EC or Japan) ought to have veto right; it is quite another to allow a minor GATT member to block consensus. Unfortunately, the two suggested principal reforms (which are still to be considered in the Uruguay Round) are probably inadequate to solve the problem of what might be called the overinvolvement of GATT members in the details of dispute settlement.

Consensus-Minus-Two: One reform would be to remove the contending Parties from the consensus requirement. In other words, in a case involving Japan and the United States, the panel report would be adopted if there was a consensus in the Council to do so, without considering the views of the United States and Japan. This reform seems eminently appropriate. It is a strange dispute settlement system that allows the losing Party to veto the decision rendered by a neutral body. The members of the GATT have, unfortunately, always been loathe in any way to give up their sovereignty in trade matters. Some countries feel that, since the General Agreement embodies an international relationship, they have to agree to lose before they can lose. I have argued elsewhere that this view is inappropriate.[15] By subscribing to an agreement with a dispute settlement system and majority voting, every GATT member consented to the possibility that they might be found to have violated the General Agreement, even over their objection. They, of course, retain the right to reject the decision and refuse to implement it or even to withdraw from the General Agreement. It goes too far to argue that the attributes of national sovereignty include all this plus the right not to be labelled a treaty violator. Indeed, it is more of an affront to sovereignty to deny the injured country its right to a day in court and a decision that the agreed-upon rules have been violated, than it is to condemn a rule breaker. If nations could be persuaded to see the problem from this perspective, the consensus-minus-two rule would be difficult to argue against, especially given that even the loser will probably benefit overall economically from following the GATT rules.

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[13] E.-U. Petersmann, "Strengthening the GATT Dispute Settlement System: On the Use of Arbitration in GATT" in E.-U. Petersmann and M. Hilf, eds, *The New GATT Round of Multilateral Trade Negotiations: Legal and Economic Problems* (1988), p. 334.

[14] E.-U. Petersmann, "Strengthening the GATT Dispute Settlement System: On the Use of Arbitration in GATT" in E.-U. Petersmann and M. Hilf, eds, *The New GATT Round of Multilateral Trade Negotiations: Legal and Economic Problems* (1988), pp. 340-341.

Despite the lack of success in persuading GATT members to yield to the consensus-minus-two rule in the past, perhaps there will be more willingness to do so in the future. The proliferation of customs unions and free trade areas in the last decades has been accompanied by an increase in a willingness of major countries to agree that trade matters may be decided over their dissent. The examples of the EC, where the consensus rule of the Luxembourg compromise has given way to qualified majority voting on many internal market issues, and the dispute settlement provisions of the Canada-US Free Trade Agreement immediately come to mind. As the major players in world trade become more comfortable with this sort of decision-making delegation, they will probably become more and more willing to allow it to occur in the GATT.[16]

Unfortunately, even though the consensus-minus-two rule is a worthy proposal, its adoption will not really solve the problem that detailed GATT member oversight of the dispute settlement process presents. Many cases in the GATT involve issues that are of direct concern to other Contracting Parties besides the two disputants. Evidence of this can be seen in the increasing frequency with which third-party countries reserve the right to offer comments on cases to dispute settlement panels. It can also be seen in Council consideration of panel reports, where third parties have from time to time expressed very strong views on the appropriateness of the decisions of panels. All of this means that even if the disputants are not considered in deciding whether a consensus for the adoption of the panel report exists, there will often be no shortage of other interested Parties that will be willing to serve as stalking-horses. Since these other Parties will have the same interests as the disputants, except that the program or practice they wish to protect has not yet been the subject of a panel decision, they should be excluded from the consensus calculation as well. Realistically, it would be difficult accurately to identify all such Parties. Moreover, even an uninterested Party might be willing to play such a role with the informal understanding that the benefited Party would reciprocate in due course.

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[15] Davey, "Dispute Settlement in GATT," *Fordham Journal of International Law*, vol. 11 (1987), at pp. 94-98.

[16] This development has also been noted by M. Hilf, "Settlement of Disputes in International Organizations: Comparative Analysis and Proposals for Strengthening the GATT Dispute Settlement System" in E.-U. Petersmann and M. Hilf, eds, *The New GATT Round of Multilateral Trade Negotiations: Legal and Economic Problems* (1988), pp. 293-294.

Consequently, the consensus-minus-two rule is a desirable reform. To allow a losing Party to block adoption of a panel report is an undesirable and unfortunate feature of the current system. As noted above, however, its adoption will not solve the basic problem of ensuring adoption of panel reports, which stems from the overinvolvement of the Contracting Parties in the specific cases considered by the dispute settlement system.

Arbitration: A second proposed reform would provide an option for disputing Parties to resolve their disputes through binding arbitration under GATT's auspices. The midterm reforms provide for this possibility, but as a voluntary option only and in a very outline form. To the extent that the decision of the arbitrators is binding, without the need for any action by the GATT Council, an arbitration system would solve the problem of Contracting Party overinvolvement in the dispute settlement system. There are, however, a number of problems with arbitration.

First, there is the question of when the binding arbitration procedures would apply. If the procedures applied only if agreed to between the two Parties, as provided in the midterm reforms, it is unclear whether the procedures would be used. Although various GATT members may well be willing to endorse this concept in principle, it is less clear that they would support it if they were worried about the outcome in a specific case.

For the reforms to be useful, it would be necessary for the Parties to agree in advance that certain types of claims or that claims between certain GATT members would always be submitted to the binding arbitration procedure. The former agreement would be quite difficult to attain unless the claims so treated were very minor. Of course, such agreements might be expanded over time if the process is thought to be working.

As a first step toward the eventual GATT adoption of a more comprehensive binding arbitration system, the optional binding arbitration proposal may be attractive. If the system can be shown to work, i.e., if the decisions produced by the arbitrators are thought to be of high quality, the system might win over those who would now question its desirability and who refuse to participate to any significant degree.

The second problem with arbitration is that the relationship of the arbitral panels to the GATT and GATT dispute settlement panels would be controversial. Parties unwilling to agree to use the arbitration procedures would, of course, object to the arbitral decisions affecting them in any way, either directly or indirectly through their incorporation into the body of precedent looked to by GATT dispute settlement panels. As a practical matter, it would be difficult for the arbitral decisions to be secret. Indeed, affected third parties would probably demand that such decisions be public and that relevant GATT provisions be effectively enforced. If the arbitral decisions become generally known within GATT, it will be difficult to keep them from affecting other GATT decisions, and they may add confusion to the precise definition of GATT rules if they are inconsistent with prior panel decisions.

To the extent that there was an agreement that all disputes of a certain type would be subject to binding arbitration, this problem would not arise, because the binding arbitration system could be fully integrated into the GATT system. If the binding arbitration procedure is in any way voluntary, then there will be the problem of fitting it into the existing GATT system. It is already thought that the proliferation of separate dispute settlement provisions in the various Tokyo Round codes has undesirably balkanized the GATT system,[17] and there have been efforts made at least to standardize the practices and procedures under those codes with each other as well as those under Article XXIII.

Thus, the arbitration proposal, at least to the extent that it would be mandatory with respect to certain kinds of disputes, might be desirable as a first step toward reducing the overinvolvement of the Contracting Parties in the GATT dispute settlement system. In addition to the practical problems noted above, however, it must be considered whether the adoption of such a mandatory system would create two classes of GATT obligations: one which a country is expected to obey, and another which is more optional in the sense that the country would retain its traditional ability to veto a decision that it had violated GATT. In any event, it seems unlikely that arbitration will be widely used in the GATT system. If it were, much more thought would have to be given to new structures within which it would operate.

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[17] See John Jackson, "The Birth of the GATT-MTN System: A Constitutional Appraisal," *Law and Policy in International Business*, vol. 12 (1980), p. 21.

A Better Approach: If the consensus-minus-two rule and arbitration offer only limited hope for improving the GATT dispute settlement system, what other alternatives can be appropriately considered? It seems to me that, in the long run, the role of the Contracting Parties in the day-to-day, decision-to-decision operation of the dispute settlement system should be reduced. I think that this might be done if they can be persuaded to change their general view of the dispute settlement system. At the present time, each case in the dispute settlement system seems to be treated as if it involved the negotiation of a new trade rule to which all Parties must initially agree, rather than as a dispute about the application of an already existing trade rule. This viewpoint explains the consensus rule. With respect to new rules, I agree that nations should be able to insist on the right to decide for themselves whether or not they are going to obey them. But I would contend that once they have agreed to obey certain rules, a dispute over whether an agreed-upon rule has been violated involves a decision of a completely different magnitude. This basic rule has been accepted by the sovereigns involved; it now only has to be applied. Since the Parties to a dispute are not appropriate judges, the interpretation and application of the agreed-upon rule should be put in the hands of a neutral body. It is only if the neutral body manifestly misinterprets the agreed-upon rule that the Parties to a dispute ought to be able to reject its decision.

Acceptance of the above reasoning would have the following consequences for the GATT dispute settlement system: it would no longer be appropriate to allow individual Contracting Parties to veto panel decisions. Instead, panel decisions would be automatically adopted unless the panel report was a manifest misinterpretation of the applicable GATT provision. There would have to be a method of deciding whether such a misinterpretation had occurred, but there would be no need for review (often detailed) by the Council of each individual case, which occurs now.

Acceptance of such a system would not truly involve much diminution of the sovereign powers of the individual GATT Contracting Parties. After all, they would have agreed upon the rule in the first place; they would have agreed upon the method of dispute settlement; and they would retain the right to refuse to comply with an adverse panel report. Indeed, they would retain the right to withdraw from GATT. A refusal to comply might involve costs in the sense that the prevailing Party might be authorized to seek compensation or impose sanctions, but the losing Party would still have complete control over its own destiny, which is all that notions of sovereignty require.

If Contracting Party involvement in the dispute settlement process is reduced, e.g., by providing for automatic adoption of panel reports, subject to the limits mentioned below, what sort of other structural changes would be appropriate in light of the problems now faced by the GATT dispute settlement system? It would seem that a separate branch of the GATT Secretariat should be formed to handle dispute settlement. This would be necessary to preserve the neutrality of the Secretariat in order to allow the Director General to use his good offices to help Parties settle their differences and to allow the Legal Office to perform its advice-giving function more neutrally. This separate branch would include only the dispute settlement panelists and a small support staff. Although there is not, as yet, a need for full-time dispute settlement panelists, it would be appropriate to choose panelists in any given case from a relatively restricted list, established by the Council, and including governmental and nongovernmental experts, so as to promote competence and consistency in GATT panel decisions.

It is unrealistic, of course, to think that GATT members would ever agree to such an arrangement without some degree of oversight to ensure that panels do not exceed their charge or otherwise act inappropriately. As argued above, a limited form of oversight is appropriate. Such oversight could come (l) in the form of Council review of panel decisions, with the understanding that the decision would be deemed automatically adopted after two appearances on the Council's agenda unless there was a consensus against adoption;[18] or (2) through the use of a special review panel, perhaps with representatives from the Council and the secretariat, that could decide whether, in any given case, Council review and adoption by consensus was necessary. The latter alternative would be preferable, in my view, because it would provide a method of resolving inconsistent panel decisions if such should occur and a means by which the General Agreement and other GATT instruments could be flexibly interpreted over time so as to ensure continued progress toward the GATT goal of ever freer international trade. The use of such a review body is somewhat, although not exactly, analogous to the procedures under the Canada-US Free Trade Agreement for review of antidumping and countervailing duty cases. That Agreement provides for national administrative decisions to be reviewed by panelists selected from a relatively limited roster of panelists, whose decisions are final except in very limited circumstances where they may be appealed to an oversight body. That oversight body is generally concerned only with whether a panel member was guilty of gross misconduct or whether the panel seriously departed from a fundamental rule of procedure or manifestly exceeded its powers, authority or jurisdiction.[19] Thus, the scope of review is not all that different from that which I propose.

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[18] This procedure has been suggested in the event that GATT adopts a form of arbitration as a method of dispute settlement. See E.-U. Petersmann, "Strengthening the GATT Dispute Settlement System: On the Use of Arbitration in GATT" in E.-U. Petersmann and M. Hilf, eds, *The New GATT Round of Multilateral Trade Negotiations: Legal and Economic Problems* (1988), p. 341.

Adoption of the approach suggested here would greatly strengthen GATT dispute settlement by providing for more experienced panelists making better and more consistent decisions with oversight by a more appropriate and neutral body than the Council. Increased respect for and acceptance of GATT panel decisions could be expected to follow.

The Continuing Need for More Effective Enforcement of Panel Decisions

The midterm reforms do not go very far in addressing the problem of how to encourage compliance with panel decisions more effectively. The reforms establish a more thorough surveillance system than presently exists, but in the end the reforms merely ensure that the failure of a losing Party to withdraw the offending measure will be raised on a regular basis in the GATT Council. It is unclear whether this act in itself will have much effect in pushing a country toward compliance.

The question of how to enforce compliance with panel decisions cannot be discussed without considering the issue of compensation or retaliation. The General Agreement does not provide a mechanism for ordering an offending country to compensate (e.g., by lowering tariffs or other import barriers) a country whose GATT rights it has violated. Article XXIII provides, however, that the Contracting Parties can authorize a prevailing Party to take actions against the losing Party to compensate the winning Party for losses suffered through the breach of the General Agreement by the losing Party. Save for one ancient case, the GATT has never done this, although it is now considering a request that it do so. It seems to me that the GATT dispute settlement system ought regularly to ask a losing Party to compensate the prevailing Party if the offending measure is not promptly removed. If compensation is not provided, the authorization of the use of retaliatory measures by the prevailing Party ought to occur as a matter of course. It would be appropriate for the original panel to consider these issues if its ruling is not promptly complied with.[20] The panel's actions would be reviewable in the same manner as its original decision.

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[19] Canada-United States Free Trade Agreement, Article 1903:13.

[20] See generally Davey, "Dispute Settlement in GATT," *Fordham Journal of International Law*, vol. 11 (1987), pp. 98-103.

On the question of whether retaliation ought to be permitted, several points should be made. First, whether or not it is authorized, it is likely to occur in many cases. The recent history of US-EC trade relations provides a number of examples. Since retaliation by self-help is likely in many cases, the failure of the GATT to authorize such action will not prevent it. It is, if anything, in the GATT's interest to regulate the extent of retaliation. Therefore, retaliation ought to be considered and authorized more frequently by GATT.

Second, retaliation is fair. There is no reason why an offender who has violated the GATT's rules ought to be allowed to continue to profit from the violation with impunity. If the violation continues, appropriate offsetting action ought to be implemented by those harmed by the violation.

Third, retaliation is often effective in promoting the removal of the offending measures through settlement because it shifts the negotiating balance between the Parties. Retaliation means that there will be pressures, both external and more importantly internal (from those adversely affected by the retaliatory measures) on the offending government to act. This makes a settlement more likely. While it may be true that retaliation raises the stakes of a trade dispute, it is not clear that this is undesirable. By focusing more attention on the dispute and on who is the presumed offending Party, it may well lead to more serious negotiations about correcting the situation. In the recent past, the United States and the EC were able to resolve or avoid trade disputes through the use or threat of retaliatory measures. As noted above, it would be desirable for the GATT to attempt to regulate such measures, something that will not happen unless there is a greater willingness to use retaliation.

Conclusion

The GATT dispute settlement system has functioned reasonably well. As it is used more frequently, however, there will be an increased risk of a breakdown due to inconsistent and unimplemented decisions unless reforms are implemented to professionalize the system and ensure its independence. This will require the reduction of the day-to-day involvement of the Contracting Parties in the system and increased attention to ensuring implementation of panel decisions. It will also require that countries found to have violated GATT rules, particularly the United States in recent cases, to act in good faith and to be diligent in correcting the violations.

VII.

Whither the GATT?

GATT and the Trade Relations System

Rodney de C. Grey

The purpose of this paper is to set out some proposals regarding the future of what is loosely called "the multilateral trading system" and on the central role of the GATT in that system or structure. I have organized these comments around issues arising in the short-term (that is, the time frame of the Uruguay Round) as well as issues arising in the longer term. Such an analysis requires a clear understanding of what the "trading system" is, the role of the GATT in that system and why the future of the system should be a matter of concern.

Introduction: What is the Trade Relations System?

Confusion is created by talking loosely about the GATT as though it is identical or coterminous with the trading system, as though the main principles of the GATT (nondiscrimination; the regulation of trade, except in exceptional circumstances, by tariff systems) are, in fact, being adhered to by major trading powers, and by assuming that the objective of trade policy operators or actors (ministers, officials, legislators, international secretariats) is the reduction of barriers to trade. To comment about the future, we ought to know where we are now, what the existing system or structure is, and what trade policy, as applied, is all about.

First, we should identify the trading system. I prefer a more exact term: the trade relations system. That term refers to the complex of arrangements and agreements between governments about how and to what extent they will intervene in or try to affect the conduct of international trade. Thus defined, the term trade relations system is intended to set aside, as a separate system, the substantial complex of arrangements and agreements which make up private international trade law. As a practical matter, although governments negotiate and put in place many of the arrangements of private international trade law, their application is not normally a function of trade policy officials. They are applied in relations between private sector entities. Disputes are settled by reference to national courts or arbitral bodies, or international institutions with specific responsibilities;[1] in such proceedings, governments are usually not parties. Of course, that this extensive body of rules is part of the trading system from the point of view of a private party buying or selling in international trade, or a private party making an investment in facilities in another jurisdiction to deliver goods or services, will be obvious enough to practising trade lawyers. But these rules are not part of the system which concerns trade policy officials.

The trade relations system refers to the complex of bilateral and multilateral agreements and arrangements between governments concerning the modalities of intervention in trade in goods and in services, and related arrangements on investment in facilities and the treatment to be accorded to foreign-controlled corporations or their branches or agents. Prior to the Uruguay Round, one would have confined the term to arrangements regarding trade in goods; it is only realistic, given the Uruguay Round agenda agreed at Punta del Este, and now extensively annotated at Montreal in December 1988, and in Geneva in April 1989, to extend the description to cover services activities.[2] Indeed, many bilateral treaties, such as the Friendship, Commerce and Navigation Treaties (FCN Treaties) negotiated with many other countries by the United States,[3] deal with trade in goods and services, and with issues of commercial presence for providers of both goods and services. The Canada-US Free Trade Agreement (FTA) sets out obligations on trade and presence with respect to goods and services. Accordingly, we should employ the term trade relations system to cover the complex of services agreements, bilateral and multilateral, and the services provisions of such agreements as FCN treaties and the Canada-US FTA, as well as agreements concerning trade in goods.

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[1] In the United Nations system, such matters are addressed, in the main, by the United Nations Commission on International Trade Law (UNCITRAL), but a variety of other international orgainizations are also involved. A useful review is UNCITRAL, Fourteenth Session, Vienna, 1981: "Current Activities of International Organizations Relating to Harmonization and Unification of International Trade Law," ACN.9/202.

[2] For a parallel discussion of the "trade relations system" as it related to trade in goods, see Rodney de C. Grey, "The Decay of the Trade Relations System" in R. H. Snape, ed., *Issues in World Trade Policy: GATT at the Crossroads* (New York: MacMillan, 1986), pp. 17-29, a paper presented at a conference of the Centre of Policy Studies, Monash University, Melbourne, February, 1984.

[3] An example of an important FCN treaty is the "Treaty and Protocol between the United States of America and Japan," signed at Tokyo, April, 1953, US/TIAS 2863. Canada has not negotiated comparable FCN treaties.

The focus in this paper is the future of the multilateral component of the trade relations system, taking the GATT as the major multilateral institution. In most trade relations issues, however, it is necessary to establish a signatory's various bilateral as well as multilateral obligations – this is obvious enough to Canadians who have entered into a bilateral agreement which has specific provisions relating some of these new obligations to GATT provisions. We can discuss what may be the future of the GATT, but it would be unrealistic to view the GATT as standing alone. GATT has to be considered in its context, which includes other arrangements such as the Treaty of Rome, the GSP, the Canada-US FTA, the various sector-specific bilateral and multilateral services arrangements, the various other regional preferential arrangements, and the agreements between nonmarket economy states (we can still use that term) and between particular nonmarket economy states and other countries. The context is extensive and complex.

If we consider the multilateral system with respect to trade in goods, the main component is, of course, the GATT. It is a multilateralized, standardized agreement modeled on the pre-World War II bilateral trade treaties (such as the 1938 agreement between Canada and the United States) which were linked by most-favoured-nation (MFN) clauses. For many pairs of countries, the GATT, initially at least, replaced these bilateral treaties; but the bilateral treaties of the 1920s and 1930s are the source of many GATT provisions and much of GATT language. Around the GATT there has developed a set of interpretive agreements and special arrangements: the Protocols of Accession or Association for a number of countries which do not adhere to all the GATT articles; the Multifibre Agreement (MFA), which provides a sort of subset of rules (inconsistent with the GATT) for a sector of trade which the major GATT signatories have long preferred to deal with by ignoring key GATT provisions; the various regional economic groupings; and the various preferential agreements, on a regional or sectoral basis, some of which clearly do not meet the criteria of GATT Article XXIV (on customs unions and free trade areas). There are also the various detailed interpretive understandings regarding the use of particular trade regulating mechanisms or devices, such as the Antidumping Code and the Subsidies/Countervailing Measures Code. There are the arrangements between certain GATT signatories, extending, as it were, the GATT apparatus into subjects not covered fully in the GATT articles (for example, standards and government procurement). There are the various waivers and releases of signatories from GATT obligations (for example, the US agricultural waiver and the provisions of GATT Part IV, which remove many GATT obligations otherwise accepted by developing countries).

The GATT, taken by itself, is complex, incoherent and not well articulated; not all obligations bind all signatories and not all signatories adhere to all its obligations. Around this central structure there are agreements regarding trade in particular goods (the commodity agreements) or regarding trade in goods with particular countries. For example, many GATT countries have trade agreements with countries which are not signatories to the GATT. The relationships between the rights and obligations created by the GATT and the rights and obligations created by these bilateral treaties are not always very clear. We may sum up by using the Curzons' description of the GATT as a multi-tiered system.[4]

It is useful, at this point, to canvass the principles or concepts which formed the basis of the initial drafting effort of the British and Americans when they developed the idea of an international trade organization late in World War II. In an earlier work[5] I set out the following essential assumptions and principles of the GATT system:

- Nondiscrimination, as set out in Article I, a most-favoured-nation (MFN) clause drafted in the unconditional form. This Article requires that concessions agreed with one GATT signatory are to be extended unconditionally – that is, without specific payment – to all other GATT signatories.

- As a corollary of the first concept, signatories will not establish new margins of tariff preference. Against the wishes of the United States, it was agreed that existing preferences (such as those granted by Canada to goods from Britain) need not be abolished; they could be maintained, but would be subject to reduction by negotiations.

- Trade should be regulated primarily by the tariff – by a price mechanism – rather than by quantitative measures, except in limited and defined circumstances.

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[4] Gerard Curzon and Victoria Curzon, "The Multi-Tier GATT System" in *The New Economic Nationalism* (New York: MacMillan, 1980), pp. 137-147.

[5] Grey, "Decay of the Trade Relations System," in R. H. Snape, ed., *Issues in World Trade Policy: GATT at the Crossroads* (New York: MacMillan, 1986), pp. 21-25.

- National treatment, as set out in Article III, which provides that, the tariff having been levied, imported goods should be treated within the domestic market no differently from domestic goods (for example, with regard to commodity taxes). One important exception was procurement by governments of goods for their own use.

- Trade is best conducted by independent entrepreneurs (that is, independent of government direction) reacting to prices as determined in open markets to which all have access. State-controlled entities are to act as though they are independent economic agents in their buying and selling. Given this view of the role of markets, it was logical to consider the tariff – a price mechanism – the appropriate technique for intervention.

- Governments retain the right to protect their domestic producers, in defined circumstances, against what they judge to be intolerable import competition. This is the basis of Article VI, which permits action against dumped or subsidized exports if such imports cause or threaten material injury to domestic industry, and of Article XIX, which permits action to limit fairly-traded imports which cause or threaten serious injury to domestic producers.

- Trade barriers are to be reduced. As the preamble to the GATT makes clear, the GATT is not about "free" trade. The GATT was about "freer" trade, about reducing the excessively high barriers – the high tariffs and the restrictive quotas – of the 1930s, and about doing so in a nondiscriminatory fashion.

- Trade relations issues are to be regulated by consultation and negotiation.

These are all long-established principles, well understood – indeed broadly agreed upon – at least in the abstract, in the Palais des Nations, if not in the Congress or the Diet. We should, however, inquire whether these essential components of the GATT system are being followed. Let us consider each of these principles as they are reflected in practice.

Nondiscrimination and no new preferences: Clearly this principle is not being followed. There are, for example, the tariff preferences accorded by the EC to goods from other European (non-EC) countries and from countries around the Mediterranean, and from ACP countries (African, Caribbean and Pacific, under the Lomé Treaty). There are also the variety of preferential tariff and quota arrangements between various developing countries and for various developing countries. There are preferences given by developed countries such as by the United States under the Caribbean Basin Initiative. There are the preferences implicit in the Canada-US FTA. Moreover, there are all the discriminatory arrangements involved in various import-restricting measures, such as those under the MFA, and the whole range of voluntary export restraints (VERs) and orderly marketing arrangements (OMAs). There are also the discriminatory aspects of the Tokyo Round Procurement Code and the Subsidies/Countervailing Measures Code. To cite these examples is not to express a judgement; it is no mere statement that the "no new preference" rule and the rule of nondiscrimination have not been adhered to.[6]

Trade regulated by the tariff: Parallel to the substantial reductions of tariffs negotiated in a series of multilateral negotiations, extensive new systems of quantitative restrictions have been developed and put in place on textiles, garments, agriculture, steel, autos, electronic entertainment equipment and more. The fact is that significant sectors of the international trade in goods are administered or managed by governments or by quasi-governmental agencies, on a quantitative basis or, in certain jurisdictions, are the subject of understandings regarding quantities to be traded which are negotiated between industries. The GATT secretariat has documented, from time to time, the growth in the system of quantitative trade controls.

National treatment: The government procurement exception has proved to be of great importance, particularly for a country such as Canada, capable of producing competitively a number of highly manufactured, specialized products which go primarily to government markets. Moreover, this procurement exception in Article III is loosely interpreted; it does not cover, on a strict reading, the purchase by government agencies of capital equipment to make goods for resale, such as the purchase of electricity-generating equipment. Article III is silent on the subject of services. The Tokyo Round Code (and the Canada-US FTA) has not succeeded in opening procurement markets for many key products or the procurement markets of subnational governments. A related issue is national treatment for facilities in the export markets, which are often required if goods (or services) are to be delivered in that market. The OECD has addressed this issue as between developed countries. National treatment for entities or facilities is bound up with the issue of right of establishment; this is an area where it is arguable that the GATT draftsmen were guilty of neglect.

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[6] On the present extent of discrimination, see Richard Pomfret, *Unequal Trade: The Economics of Discriminatory International Trade Problems* (Oxford: Basil Blackwell, 1988), especially chapter 10.

Open markets: It has become clear that governments can affect the so-called open markets not only by tariffs (and subsidies) and discriminatory quotas, but by setting trade-restricting product standards, by restricting establishment, by trade-related investment measures and by the regulation of product and service markets which may (sometimes accidentally, sometimes as a matter of policy) discriminate against foreign sources. This is quite evident in the services sector. Moreover, the GATT provision leaves to one side an insoluble problem, insoluble in terms of broad principle but perhaps to be dealt with pragmatically: how are trade relations to be regulated between the so-called market economies and the nonmarket economies? As a practical matter, the market economies have had to adopt concepts of bilateral reciprocity, usually in terms of annual balancing of quantities traded, in dealing with the nonmarket economies, or they have applied their antidumping provisions in contrived and protectionist forms.

The right to protect against intolerable import competition: Action under Article VI is the subject of detailed procedural provisions in the two Article VI codes (developed in the Kennedy Round and then in the Tokyo Round). These form the centerpiece of the contingency protection system which, in my view (and now in the view of some others[7]), has become a protectionist system. As for Article XIX, the real value of the GATT to small countries was thought to be that, by virtue of Article XIX, they secured a measure of protection against arbitrary and discriminatory import restrictions by the larger countries. Altogether aside from the issue of whether this should be thrown away by adopting selectivity with respect to Article XIX, in garments and primary textiles a highly organized and detailed set of arrangements has been put in place for ignoring the rules of Article XIX: organized evasion. The MFA allows discrimination and, moreover, abandons the Article XIX disciplines of retaliation by the exporting country or of offsetting concessions by the importing country.

Measures which involve nonadherence to the provisions of Article XIX and the development of contingency protection under Article VI, plus the elaborate apparatus of subsidization and import restrictions in the agriculture sector, have together made managed trade or administered trade the centerpiece of trade policy.

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[7] For an authoritative US view, see Noel Hemmendinger, "Shifting Sands: An Examination of the Philosophical Basis of US Trade Laws" in John H. Jackson, Richard O. Cunningham and Claude G. B. Fontheim, eds, *International Trade Policy: A Lawyer's Perspective* (New York: Matthew Bender for the American Bar Association, 1985), pp. 2.01-2.10.

Reductions in trade barriers: It is clear that tariffs on industrial products are now lower. But are trade barriers really, overall, significantly lower? One could argue that the enormous expansion in world trade shows that, on balance, barriers have been reduced. This is plausible, but it ignores the fact that increases in managed trade are managed increases. It may be that increasing specialization, and therefore increased trade, has occurred, not because of negotiated reductions of certain trade barriers, but because of technological changes, because of the growth of transnational corporations (which are able to internalize trade policy), and because a number of governments have developed and applied effective industrialization policies. And one could ask, are barriers to trade in agricultural products lower now than in the early years of the GATT?

It would be extremely difficult to try to quantify the impact of decisions in sectors where trade is managed, to try to quantify the impact of various contingency measures – particularly given the importance of precedent in their application – and to try to quantify the trade impact of agricultural policies – particularly of the variable levies and the export restitutions. Many barriers to trade, being of a standby or contingency character, are difficult to detect and virtually impossible to measure.

GATT as a forum for negotiating trade problems: The notion of negotiating disputes and difficulties, and doing this in a multilateral forum or in the context of multilateral rules, and giving up the right to unilateral retaliation without international rules, works better when there are not great disparities in power. Now that there are two trade superpowers, many (if not most) trade policy issues are negotiated between them and the resulting decisions imposed on the remaining participants. Of course, there may be room for securing some accommodation of the interests of smaller countries by ingenious and informed representation, as the operation of the Cairns Group in the Uruguay Round agricultural trade discussions makes clear. As for the GATT dispute settlement practices, it is fairly clear from a number of recent and current cases that neither the procedures nor the standards of panel adjudication are always satisfactory.

The above provides a brief indication of how GATT rules are evaded or inadequate. It should be noted, however, that in the area of subsidies the rules are more than merely inadequate. For tariffs, the rules are detailed and precise; for subsidies they are imprecise and general. There have been several efforts to deal more appropriately with subsidies: in the 1955 Review Session, in the Tokyo Round, and it is again on the agenda for the Uruguay Round.

In the light of the above, it is evident that there is a dilemma. A strong case can be made that the GATT as a set of rules is no longer effective, if it ever was. It is arguable that it no longer serves adequately the interests of smaller countries, that it no longer serves effectively the interests of even the larger countries – which also need rules, if only to protect themselves against themselves: that is, against the unremitting pressure of special interests.

But the GATT remains the only apparatus, the only forum. We have to address trade policy issues multilaterally and the ambitious agenda of the Uruguay Round is a recognition of this. I do not think, however, that any useful purpose is served by talking as though the objective of trade policy – or, more concretely, the objectives of ministers, officials, interest group representatives and legislators, in formulating the details of trade policy – is liberalization. One should not take too literally the presentational and ritualistic phrases which can be used to embellish what, in practice, may be protectionist devices. I view cynically, for example, the phrases of the 1988 US Omnibus Trade and Competitiveness Act, which assert that the trade policy negotiating objectives of the United States are "more open, equitable, and reciprocal market access; the reduction or elimination of barriers and other trade distorting policies and practices; and a more effective system of international trade disciplines and procedures."[8] These objectives are inconsistent with a number of US trade policy practices; it would be tedious to recite a list. Trade policy officials know that, while trade policy may involve efforts to reduce barriers to exports and may involve efforts to remove some import restricting measures (which clearly impose costs on the domestic economy), trade policy is essentially about discrimination and preferences (the Canada-US Automotive Products Agreement and the FTA should make this clear). Trade policy is about selectivity (in the MFA, and in the use of surrogates for Article VI measures). Trade policy is about regionalism and bilateralism. In sum, trade policy is about how the rent of the various measures, in application, is to be allocated among interest groups.

The Short-Term Outlook: Prospects for the Uruguay Round

Against this background one can ask: what are the prospects for the Uruguay Round? In my view, the Uruguay Round is "short-term." First, the course of the Uruguay Round to date – the working out of the Punta del Este agenda for the Round, the Montreal outcome, and the decisions reached in Geneva in April 1989 – has not encouraged me to change the view I expressed in 1983, specifically, that we should be focusing on adhering to the GATT rather than on extending that system to new areas:

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[8] Section 1101 (a).

> The key question ... is whether we should be devoting our efforts, our negotiating skills, to trying to extend this system, or an analogue of this system, to traded services, to investment and to trade in high technology products, or whether it would be more prudent and more useful to see whether "managed" trade could be brought under a greater degree of international scrutiny and whether the excesses of contingent protectionism could be better controlled. Moreover, from the point of view of developing countries, it would be more useful to talk less about the possible "gains from trade" which will accrue to the services firms and high technology enterprises of the industrialized North, and more about the need to open the markets of the North to industrial products of developing countries so that they may earn the funds to meet at least the interest on their obligations. From their point of view, the trade relations system should be about the link between trade and development, and the corollary issue of structural adjustment. As they see it, discussions about services and other newer issues should begin with development considerations and not deal with that overriding issue as a matter only for "special and differential treatment," or as an excuse for derogation from the basic rules.[9]

With respect to the Canadian interest in the proposed negotiations,

> ... the Canadian objective ... should be the repair and strengthening of the existing system, not its extension to new areas or sectors. More specifically, that means trying to bring the "contingency system" under control (by revising the Article VI codes); strengthening the procedures of Article XIX, not weakening the system by embracing discrimination; addressing the issue of how to develop rules, or at least some procedural approach, about "structural adjustment" (and there are very few ideas about on that), including adjustment in agricultural production; and addressing, in a continuing fashion, the flux of questions regarding the access of manufactured products from the South in the markets of the industrialized world (that will mean looking at Article VI measures, as they bear on such exports; at the Generalized System of Preferences, at tariff escalation; and, of course, the MFA). This is, of course, a most unattractive agenda to the EEC and the US.[10]

We have, however, embarked on the Uruguay Round, an enterprise which, despite the enactment of the FTA, Canadians would not wish to see fail. While it is not appropriate in this analysis to provide a detailed assessment of the progress under each head of the Uruguay Round negotiations, some important issues that will run into the longer term should be noted:

Agricultural Trade: Along with many others, I had hoped that the coincidence of budgetary pressures and bad weather would provide the occasion to begin the process of reducing subsidization, import protection and the distortion of trade in the agricultural sector. The text agreed upon in Geneva does not preclude this possibility, but we shall have to wait and see. The text is sufficiently obscure that one cannot rule out the possibility that a failure on agriculture may yet collapse the Uruguay Round. Apparently, EC spokesmen have stated that the recent agreement puts the Community "under no international onus to make further cuts in farm support."[11] That this was stated publicly is a bad omen.

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[9] Rodney de C. Grey, "The Decay of the GATT System," an unpublished paper prepared for a 1983 pre-Summit Seminar in Ottawa.

[10] *Ibid.*

Textiles: If one keeps in mind that no convincing case was made when the MFA was launched that the rules of Article XIX of the GATT would prevent restrictions on imports being imposed by any signatory as would have been necessary to prevent serious injury to domestic producers[12] – and it is doubtful that such a case could be made now – then it is evident that the Geneva text on textiles is a miserable result. It can only be that it is acceptable to textile exporting countries because some of them value the market-allocation and market-guarantee aspects of the MFA as it operates. But to propose, after almost two years, that at the end of the Uruguay Round the negotiations should have reached agreement on "modalities that would permit the eventual integration of this sector into GATT on the basis of strengthened GATT rules and disciplines, thereby also contributing to the objective of further liberalization of trade" (emphasis added)[13] shows how little will there is to scrap the MFA. The phrase suggests that negotiations on textiles will depend on the weakening of the conditions and criteria of Article XIX.

Article XIX (Safeguards): In the Tokyo Round, the great pressure mounted by the EC for "selectivity" was successfully resisted; this was the avoidance of a retrograde step and, in that sense, the negotiation was not a failure. On the other hand, no progress was made in bringing under Article XIX, and under an effective surveillance, the great range of measures taken by countries as "surrogates" for Article XIX action. That was a failure.

The problem is not one of inadequacies in the provision of Article XIX. The problem is that neither the EC, the United States nor for that matter, Japan, are willing to live by the rules of Article XIX. This being so, either the rules of Article XIX have to be changed, so as to legalize sin – or at least to bring sin under scrutiny – or countries have to at last recognize that it is in their own interests to avoid the use of Article XIX surrogates. Inevitably, there are measures that impose high costs on consumers in the importing country (although one can exaggerate these costs); they impose costs on producers, which rely on imported inputs, or on inputs for which import competition is thus reduced. They are measures which delay, sometimes for long periods, the necessary adjustments of the structure of production. They are, moreover, usually inconsistent with competition policy in that they endorse restriction and cartelization. I do not think that we should rush to amend Article XIX; we should begin by scrutinizing, at the international level, the reasons why, in a given case, particular countries prefer surrogates to Article XIX action.

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[11] David Bucher, "New GATT guidelines favour Europe on farm aid," London, *Financial Times*, April 11, 1989.

[12] Noel Hemmendinger, "Shifting Sands: An Examination of the Philosophical Basis of US Trade Laws," in John H. Jackson, Richard O. Cunningham and Claude G. B. Fontheim, eds, *International Trade Policy: A Lawyer's Perspective* (New York: Matthew Bender for the American Bar Association, 1985), pp. 2.01-2.10.

[13] The phrase is from the draft text put before officials at their meeting in Geneva, beginning April 5, 1989.

In this context, we should not overlook the fact that the EC has been able to deploy its antidumping provisions selectively to deal with what might be thought to be Article XIX cases. This makes it clear that reform of Article XIX, if any reform other than adding a surveillance body is necessary, should proceed only in parallel with reform of the Article VI codes.[14]

We should not rule out that common sense, and a more sophisticated calculation of the costs and benefits of protection, could lead to some surrogate measures being allowed to lapse or being phased out. One notes that recently Mr. Bangemann, the EC Commissioner for Industry and the Internal Market, has called for the removal of restrictions on automobile imports (in parallel with the removal of technical barriers to trade in automobiles within the EC[15]). This may, however, be no more than a way of saying that it would be better for Japan to restrict exports than for the EC to restrict imports.

Services: As has been argued earlier in this paper, a case could be made that it would be more important to make the GATT function effectively in regard to trade in goods rather than to try to extend GATT concepts to services. Now that we are committed to negotiating about services, however, one might hope that something real could be achieved. The services text approved by Ministers at Montreal shows how difficult it is to make progress on services as a general issue; that text is not much more than an agenda for further discussion. While one could be optimistic and more ambitious, it may be that all we can expect from the Uruguay Round under services is some sort of declaration, some exhortation, the creation of a forum for ventilating disputes and the establishment of a venue for later negotiations on rules for specific services sectors.[16] It may be that, given the problems which are specific to particular services sectors, and the extent of entrenched protectionism in such services industries as transport and insurance, that progress will be slow. It may be that the United States and Canada, for their part, and the EC will be able to make much greater progress on liberalizing services activities on a regional basis than will prove possible on a multilateral basis. Perhaps we should consider whether services liberalization might not be tackled on a Western Hemisphere basis (probably sector by sector). Canada and the United States, having done some pioneering work on services in the FTA, might consider what might be negotiated with the countries of Latin America.

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[14] For a comprehensive discussion of the Article XIX issue, see UNCTAD, Note by the Secretariat, "An Improved and more efficient safeguard system," TD/B/978, February 1984; see also "Anti-dumping and countervailing duty practices," TD/B/979, January 1984.

[15] William Dawkins, " EC calls for an end to car quotas," London, *Financial Times*, April 9. 1989.

Subsidies and Countervailing Measures: The negotiating effort appears to be directed primarily at the taxonomy of subsidies. This may prove as unproductive in the Uruguay Round as it did in earlier sessions. If Canadians expect that they can work out a special deal with the United States on countervailing duty, then the discussion in Geneva may be of no great importance. If no bilateral deal is feasible, however, then the Geneva negotiations will assume much greater significance.[17]

Dispute Settlement and the Functioning of the GATT System (FOGS): Nothing is to be gained by knocking the marginal procedural improvements agreed by Ministers with respect to the GATT dispute settlement process, and it is useful that those new rules come into effect now rather than at the end of the Uruguay Round. The evolution of a number of recent GATT disputes has shown, however, that the system depends on the willingness of the major trading countries to abide by panel proposals when those panel proposals are clearly correct. Lacking that willingness, minor procedural reforms to what is not, as a process, technically inadequate, will achieve little. It is clear that how the United States reacts to the recent panel report on section 337 may be of considerable importance for determining the future of the GATT procedures.[18]

On the work of the FOGS Group, it may well be that better discipline over trade policy and a more effective GATT will develop as a result of the Trade Policy Review Mechanism being put in place. This may turn out to be one of the positive and substantial achievements of the Uruguay Round.[19] Here again, while the Secretariat will have an important role to play, the essential contribution to making the system work must come from national capitals.

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[16] John H. Jackson, "Constructing a Constitution for Trade in Services," *The World Economy*, vol. 11, no. 2 (June, 1988), pp. 187-202.

[17] See Rodney de C. Grey, "Some Propositions About Domestic Subsidies," paper prepared for Montreux Conference (1989) of the Centre d'Études Pratiques de la Negociation Internationale, to be published by the World Bank.

[18] GATT L/6439 of 16 January, 1989, "Report of the Panel/United States – Section 337 of the Tariff Act of 1930," p. 72 (not published).

These comments on some of the more important items on the Uruguay Round agenda, taken together, constitute a short-term outlook on the GATT. How the issues are tackled will determine what sort of GATT we have at the end of the Round. Clearly, the hard part of the Uruguay Round is about to begin.[20]

The Longer Term: Issues to be Addressed

There will be some major issues left over or left unfinished when the Uruguay Round concludes. Clearly, this will be the case for agriculture, textiles and services. The negotiations will have begun or will be in prospect. The conduct and outcomes of the long negotiating processes clearly in prospect for these three areas will be crucial in defining the long-term role, or the long-term decline, of the GATT. As for the dispute settlement arrangements, there is a practical limit to procedural tinkering. Without an effective dispute settlement system, an international agreement such as the GATT would lack real meaning and would lose what remains of its contractual character. But the onus is on the signatories to make the system work. As for safeguards, here too the onus is on signatories. We need some sort of surveillance mechanism for Article XIX measures, and it should be one that tries to be impartial in the rigour of its surveillance – it should favour neither developing countries nor the big three, nor should it demonstrate its effectiveness solely by scrutinizing the smaller developed countries with undue vigour.

It is not necessary to contemplate the state of play in the Uruguay Round in any great detail as the basis for developing a longer term view. What is necessary, however, is to take note of issues which are not on the Uruguay Round menu, and to consider the implications for the multinational trade policy system in general and the GATT – at the centre of that system – failing to address those issues. The three issues, each of great importance – including political importance – are (1) the extent of discrimination and of preferences; (2) the central role of contingency protection (antidumping and countervailing duty provisions under the Article VI codes, and managed trade and surrogates for Article XIX action); and (3) the evolving issue of trade relations between the so-called market economies and the various and changing non-market economies.

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[19] For a discussion of trade policy surveillance, see Richard Blackhurst, "Strengthening GATT Surveillance of Trade – Related Policies" in E.-U. Petersmann and M. Hilf, eds, *The New GATT Round of Multilateral Trade Negotiations: Legal and Economic Problems* (Place: Kluwer, 1988), pp. 123-155.

[20] Lead article: "GATT: now for the hard part," London, *Financial Times*, April, 1989.

As for the widespread recourse to discrimination in trade policy – including regional preferential arrangements, the various preferential arrangements between various developed countries, and between various developing countries, and between various developed countries and various developing countries – I suggest that there is a case, based on the self-interest of each GATT signatory, for going back to basics. Obviously, if there is a substantial reduction of tariffs agreed in the Uruguay Round, margins of preference in the tariffs of developed countries will be reduced and thus the impact of preferences as a system will be somewhat reduced. To the extent that the United States reduces its MFN tariff rates, the preferences accorded Canada under the FTA will be reduced; this will, in turn, reduce the political leverage which inevitably derives from the granting of trade preferences by a large power to a smaller power.[21] But it will remain that the bulk of world trade will continue to be conducted under preferential rather than MFN tariff rates. Indeed, the trade policy of the EC towards other countries is based essentially on the ability of the EC to take discriminatory action, including the granting of preferences.[22] It will be difficult to persuade the EC that less discrimination in trade policy will be in its own interest, but I think it can be demonstrated that this may be the case.

The real initiative has to come from developing countries, some of which may still be under the illusion that they benefit from preferential access to the markets of developed countries. We might hope that they may eventually realize, as Canadians understood in relation to the Commonwealth preferential system, that trade preferences are a method which powerful, metropolitan powers may use to secure additional leverage over smaller, dependent, export-oriented economies. That extra leverage, that increment of power, can be deployed to induce smaller countries to act in accordance with the views of the larger power over a wide range of issues in noneconomic as well as economic contexts. Preferences and discrimination in trade policy are primarily about power; of course, they also create rents, but I suspect that in the normal course those rents accrue to the larger entity. What the developing countries need in order to encourage the direct investment in production facilities required for development, are clear contractual terms of access to developed countries' markets. That means no or lower tariffs, bound by the GATT against increase and applied on an MFN basis. Low tariffs on their own imports are also in the interest of each developing country. The case that high protection imposes crippling costs on the protected economy is just as valid for a developing country as it is for Canada.

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[21] One may note the views of Jacob Viner, *The Customs Union Issue* (New York: Carnegie Foundation, 1950), at pp. 91-92: "Of the more serious [preferential] movements which involved a great power and a small country or a number of small countries, it appears to have been the case without exception for the great power that political objectives were the important ones." For small countries entering into such preferential arrangements: "... only the economic consequences as a rule were regarded as attractive, while the political aspects were thought of as involving risks which might have to be accepted for the sake of the economic benefits with which they were unfortunately associated."

[22] Richard Pomfret, *Unequal Trade: The Economics of Discriminatory International Trade Problems* (Oxford: Basil Blackwell, 1988) and Gardner Patterson, "The European Community as a Threat to the System"in William R. Cline, ed., *Trade Policy in the 1980s* (Washington: Institute for International Economics, 1983), pp. 223-242.

A newly-revitalized GATT would be the proper forum for addressing this issue. The GATT preamble, legally devoid of any effect, states that nondiscrimination and the reduction of trade barriers are the objectives of the signatories. Perhaps this could eventually become the case.

As for reform of the contingency protection system (or administered protection), one important component (the surrogates for Article XIX action) is on the Uruguay Round agenda. No very serious attempt is being made, however, to bring sanity into the administration of the antidumping and countervailing duty systems. I have written elsewhere on the excesses of these two types of measures and made proposals for reform, and there is now a substantial volume of writing about what is wrong with these two types of contingency protection measures.[23] Surely it is not necessary to explain to a Canadian audience, familiar as it must be with how countervailing duty and antidumping duty can be applied to our exports, how protectionist these two measures – said merely to be addressed to unfair trade practices – have now become. It is in this area that there is need to make trade policy more consistent with competition policy.

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[23] See Brian Hindley,"Dumping and the Far East Trade of the European Communities," *The World Economy,* vol 11, no 4 (December, 1988), pp. 445-464; Noel Hemmendinger, "Shifting Sands: An Examination of the Philosophical Basis of US Trade Laws" in John H. Jackson, Richard O. Cunningham and Claude G. B. Fontheim, eds, *International Trade Policy: A Lawyer's Perspective* (New York: Matthew Bender for the American Bar Association, 1985), pp. 2.01-2.10; Grey, "Some Propositions About Domestic Subsidies," paper prepared for Montreux Conference (1989) of the Centre d'Études Pratiques de la Negociation Internationale, to be published by the World Bank; and UNCTAD, Note by the Secretariat, "Anti-dumping and countervailing duty practices," TD/B/979, January 1984.

There is an overwhelming case for reform of the GATT rules and for new rules. Of course for Canada, the focus must be on the promised negotiation on this subject with the United States under the FTA provisions. One would like to think, however, that Canadian interest in exports to Europe would be sufficient a motive to address these issues in Geneva. Progress in Geneva would reduce the bill to be faced in the bilateral negotiations with the United States. I doubt that there is any great possibility of adequately addressing this issue in the Uruguay Round. Indeed, the thrust of current policy is to make the provisions more effective – that is, more protectionist. And clearly, reform is not going to be generated in meetings of the Antidumping Committee or the Committee of Signatories to the Subsidies/CVD Code in Geneva; these meetings consist largely of defensive exercises combined with some exchange of technical administrative knowledge, none of which constitutes a remit for reform. It is inescapable that real reform of the system will come only from some increased recognition in national capitals that the antidumping and countervailing duty systems are excessively protectionist and that they are anticompetitive, and thus impose unnecessary and burdensome costs on the protected economy.

Finally, in constructing a tentative post-Uruguay Round trade policy agenda, there is the issue of how to work out a somewhat more rational framework of trade agreement relations between market economies which are signatory to the GATT such as Canada and nonmarket economies (some of which are within the GATT system, in a sense). As a structure of domestic markets begins to emerge in these so-called nonmarket economies, we should think out just what sort of revised framework of rules would be more appropriate. Clearly, access to markets on an MFN basis is the key concept but, for the present, that is an inherently difficult rule for nonmarket economies to apply. There is also the issue of how to deal with unacceptable price competition from these economies, including price competition in services sectors. At present, much of this is being dealt with by the contrived use of the antidumping provisions by the EC, the United States and Canada.[24] This is stretching the antidumping system too far. Whether we address this item on the agenda within the framework of reform of the antidumping system, or within the context of revising trade agreement relations with the countries concerned, depends in part on decisions in respect of GATT membership. But the political importance of revision of our trade relations arrangements with the nonmarket economies, in the emerging context of their economic reforms, is fairly obvious.

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[24] See Sev Hirsch, "Anti-dumping Actions in Brussels and East-West Trade," *The World Economy,* vol 11, no 4 (December, 1988); Frank L. Fine, "EEC Antidumping: The Problem of Imports from State Trading Countries," *Law and Policy in International Business,* vol 20, no. 1 (1988); Don Wallace Jr., George C. Spina and R. M. Lawson, eds, *Interface One* (Washington: The International Law Institute, 1980); and Don Wallace Jr. and D. A. Flores, eds, *Interface Two: Conference Proceedings on the Legal Framework of East-West Trade* (Washington: The International Law Institute, 1982).

I have left to the last, and in a subordinate position, the issue of what can be done about the status and role of the GATT as an institution. Consideration of proposals to recreate an international trade organization, which is what we need, remains subordinate to the development of ideas and opinions in the capitals of signatories. But clearly what has already been agreed upon (at Montreal) regarding dispute settlement and the better functioning of the GATT system has implications for the GATT as an institution. For the present, it is important to focus on substantive policy questions which will have to be addressed as the Uruguay Round develops, and after. But there is wide agreement that the Secretariat should be strengthened and that the GATT should be better funded. I would go further: we should consider whether the time is coming to create a much stronger body, possibly by merging UNCTAD into the GATT apparatus, and by getting it more clearly accepted that, within the international structure, it is the GATT which has the prime responsibility for trade policy, not merely for storing the contract.

Conclusion: the Responsibility of National Governments

The agenda I have constructed for the longer term – which includes such continuing matters as developing rules for agricultural trade, the effective working of the GATT dispute settlement system and the better functioning of the GATT as a trade policy institution – are matters where the necessary initiative, the necessary impetus, cannot reasonably be expected to come from international officials, important though their participation and contribution will be. Revision of the trade relations arrangements with nonmarket economies will be politically important. But radical reform of the contingency protection system (including safeguard surrogates) and the development of rules for agriculture will require policy invention, the mustering of political will, the shrewder calculation of self-interest and the more skillful construction of domestic alliances against protectionism. It is in various national capitals that the consensus for strengthening the trade relations system must be created.

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The Centre for Trade Policy and Law (CTPL), established in 1989, is jointly sponsored by The Norman Paterson School of International Affairs at Carleton University and the Faculty of Law at the University of Ottawa. CTPL was established to promote greater public understanding of trade policy issues, to foster independent analysis and research of trade policy issues, and to encourage the development of trade policy professionals. The core of the Centre's program includes a range of interrelated activities:

Teaching. Starting with increased resources dedicated to teaching graduate and professional students at the two sponsoring universities and programs for government staff and business and labour organizations, CTPL will act as a catalyst to the development of teaching programs at other Canadian universities by working with faculty in sponsoring the preparation of teaching materials, encouraging faculty interchanges and holding periodic seminars on the teaching of trade policy in Canada.

Seminars and Conferences aimed at wider audiences where academics, government officials and private sector specialists can explore a range of trade policy issues and stimulate greater public discussion of trade policy issues.

Research and Interchanges. CTPL encourages both applied and theoretical research in the area of trade policy by helping qualified scholars obtain the necessary funds to carry out their research. Research will also be promoted through the publication of monographs and conference proceedings and eventually a new journal, as well as the development of a resource centre to act as a central repository for material on trade policy. CTPL will promote its national mandate by inviting scholars from across Canada to participate in seminars, special lectureships, conferences and research projects and stimulate a flow of human resources between academic, government, business and labour organizations.

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LIVING WITH FREE TRADE

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The Canada-US Free Trade Agreement came into effect on January 1, 1989, following a period of intense, and often emotional, public debate in Canada. The debate covered both the broad policy implications for Canada of developing closer formal relations with our southern neighbour, as well as the specific obligations contained in the Agreement. One of the incidental benefits of this process has undoubtedly been the increased public awareness of the institutional and legal framework for international trade and its importance to Canada as a trading nation.

Canada is currently an active participant in the Uruguay Round of GATT negotiations. This Round is the most ambitious and extensive since the negotiations that established the General Agreement in 1947. Negotiating groups are working assiduously at reducing barriers to trade and clarifying and improving rules. Ground-breaking discussions are taking place in the groups responsible for the "new" issues, including trade in services, intellectual property and investment.

The articles in this volume address some of the issues that will arise as Canadian business moves to take advantage of reduced barriers under the Free Trade Agreement and responds to the challenges of freer trade globally. Together these articles provide a comprehensive overview of the critical trade policy issues affecting Canada as we forge ahead into the last decade of the twentieth century.

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